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AFRICA VENTURE CAPITAL PROJECT

FINAL

DEVELOPING PRIVATE SECTOR ENTREPRENEURSHIP: IN THE GAMBIA

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EXECUTIVE SUMMARY

The purpose of the visit to The Gambia by Michael Warman, the Consultant, was to evaluate the need for and viability of Venture Capital.

The easy part is determining the need for Venture Capital. There clearly is such a need.

The difficult issue is determining how to provide Venture Capital in a form which is viable and which maximizes the effect of Venture Capital's catalytic role in fostering private sector entrepreneurship. This is all the more problematic given the size of the Gambian economy, the relatively undeveloped financial sector and the absence of a successful model for Venture Capital in other developing countries which can be adapted to The Gambia.

Hence, in examining the viability of Venture Capital in The Gambia, it is necessary to examine the enabling environment, in particular the development of the financial sector. In fact, these are necessary preconditions to Venture Capital.

Section 1

This section defines Venture Capital, USAID's role and places Venture Capital in context: both in terms of The Gambia as well as the financial sector and other aspects of the enabling environment. As Venture Capital is a form of investment, the environment for investors in The Gambia is examined.

Venture Capital not only provides risk capital but also needed skills and services to entrepreneurs. The process involves an activist, hands on partnership between the Venture Capital Unit and the entrepreneur.

There is a need for Venture Capital in The Gambia. The commercial banks are not providing investment capital and the The Gambia Commercial Development Bank (GCDB) - the Government owned development finance institution - has been wound up. Lending tends to be made on a fully secured basis and not on the basis of cash flow, management and growth prospects. Moreover, real interest rates at 10-15% are high and the total cost for borrowing, when one factors in hidden costs, is exhorbitantly high - beyond the capability of most businesses except those engaged in the highly profitable, short term oriented re export trading.

At present in The Gambia, business and finance tend to be focused on short term activities dependent on artificial exogenous factors. It is difficult to get businessmen, bankers and investors to think and plan for the medium to long term, let alone to participate in risk capital, when excellent returns at little risk are being made in short term oriented activities such as re export trading, foreign exchange and Treasury Bill purchasing.

This is the challenge facing the Government. It must take the lead in creating an enabling environment conducive to investment.

Ultimately, Venture Capital only will work with significant local participation. That is, sources of capital primarily should be mobilized locally, the management of the financial vehicle which is providing Venture Capital should be indigenous and the entrepreneurs mainly Gambian. This is not possible at the moment.

The commercial banks are not mobilizing local sources of capital in an efficient manner and channeling them into productive investment. That is, they are not performing their allocative role. There is no securities market whatsoever. Hence, financial intermediation is severely constrained as are liquidity and exit mechanisms to realize capital gains or losses.

In terms of management, the raw talent is available. However, education and training are required to transform the raw talent into capable professionals in the areas of Venture Capital and other aspects of merchant banking.

In terms of entrepreneurs, there are a number of talented individuals with suitable projects who are in need of risk capital and services which can add value to their businesses. These entrepreneurs cannot obtain, to any meaningful degree, term finance at an affordable cost from the commercial banks.

It is always possible immediately to set up a specialized Venture Capital company, funded mainly by donors and staffed by employees of donors. However, given the prevailing enabling environment and the experience with such entities in other developing countries, it is likely to fail while in the meantime absorbing millions of dollars of donor subsidies to cover the budgeted pre operating costs and operating losses for at least the first five years.

A specialized Venture Capital company cannot be viable in The Gambia, even in the long term. The market is too small to sustain a specialized financial entity of this kind.

Venture Capital, which is aid dependent and donor driven is a contradiction in terms and a recipe for failure.

Donor funds alone are not what is needed. They are the simple way out, but not the way to provide a significant benefit to the Gambian private sector. The Gambia's Official Development

Assistance (ODA) per capita was $106 in 1991. This is one of the highest levels in the world. However, even after years of significant ODA funding UNDP's 1993 Human Development Index (HDI) ranking for The Gambia is only 167 out of 173 countries while its GNP per capita rank is 148 out of 173. The HDI ranking offers a measure of development far more comprehensive than GNP alone. It combines indicators of real purchasing power, education and health. GNP can be very misleading as it does not take into account the distribution of income, among many other factors affecting the quality of life.

A step by step gradualist approach is recommended as the way to create the suitable environment for Venture Capital. It will take longer than simply setting up a Venture Capital company irrespective of the environment. However, this gradualist approach has a much better chance of generating significant long term benefits to the country while at the same time involving less sunk in grant monies or subsidies.

Venture Capital typically emerges at a fairly mature stage of financial sector development. Yet in The Gambia, the financial sector is at an early stage of development. It is inappropriate to contemplate Venture Capital when there is not even a money market, aside from a capital market.

Developing a money market, including an Over the Counter market for unlisted securities, should be an immediate priority. In time, as investor confidence and understanding grows, there will be scope for introducing capital market instruments.

The need for a securities market is all the more pressing due to the oligopoly of the commercial bank credit market and their lack of attention to the needs of their customers. As the commercial banks are presently dealing with a captive market, their franchise is not dependent on quality of service. Competition and financial deepening are vital. A securities market will help as will new financial institutions such as a discount house, a securities company and a merchant bank.

There is no shortage of entrepreneurship in The Gambia. In this mercantile economy, the Gambians are born traders. They live by their wits. There is no shortage of liquidity, capital or aid in The Gambia. The country is awash with it.

There is no shortage of talented individuals, both entrepreneurial as well as those suited to working in a financial institution which will engage in Venture Capital as one of its activities.

What is missing is an efficient mechanism of financial intermediation along with a supportive enabling environment to mobilize domestic sources of capital and to channel it into productive investments.

Establishing a merchant bank is recommended as a suitable vehicle to provide financial intermediation, including Venture Capital. A merchant bank engaging in a variety of financial products and services will reap synergistic and cash flow benefits otherwise not available to a specialized Venture Capital company. This merchant bank additionally can perform an advisory role to the Government in preparing the groundwork for Venture Capital with the enabling environment.

A Venture Capital strategy for The Gambia should focus on labor intensive activities, low skilled light manufacturing or processing and production slated for the export market.

Due to the size of the country, the stability of the Government and its people, there is a better chance of successfully developing Venture Capital in The Gambia than in many other countries.

The Gambia has the potential to be a model for other developing countries.

Section 2

This section examines the macro preconditions - the enabling environment - influencing the viability of Venture Capital in The Gambia.

Venture Capital ultimately involves an investment in people. Hence, investment in education, training, skills transfer, business development programs and the The Gambian diaspora is a key factor in the success or failure of private sector entrepreneurship.

In terms of the economic environment for Venture Capital, interest rates and tax policy are significant impediments.

Interest rates for borrowings have to come down from the present levels of 21-26% to 10-15%. The current levels set too high a hurdle rate of return for equity investment, especially when inflation is around 10%. The Central Bank can play an active role in pressuring interest rates down through Open Market Operations, the discount rate and the Treasury Bill rate.

There are many impediments to risk capital in the present tax system. These impediments need to be removed and incentives provided.

Government policy specifically towards investment is an important element of the enabling environment.

The Gambia is a tiny player in a worldwide market for investors. To attract quality investors to The Gambia, tangible incentives need to be provided. The current Development Act does not provide significant incentives when compared with what is offered by other countries which are better known to investors. The scrapping of the Development Act is recommended. What is

suggested is for it to be replaced by an Investment Promotion Act which will provide significant incentives to investors.

There is a need for a securities market as well as related financial institutions. Even though the The Gambian market is tiny, it is nevertheless a relatively dynamic market which can sustain several new financial institutions. As language and colonial differences break down, there is no reason why Gambian institutions cannot have a regional presence.

With the focus of development on the export sector, an Export Credit and Insurance Program is recommended.

In terms of the legal environment, existing legislation needs to be examined to remove any impediments to securities market development, including Venture Capital.

There are a host of recommendations concerning the prudential and regulatory and supervisory environment. These mainly relate to the Office of the Commissioner of Insurance and establishing a Securities Market Authority.

Accounting and auditing recommendations are made as well as provisions for the disclosure of material information.

The infrastructure environment can be a significant incentive or impediment for investors. In The Gambia, the telecommunications is relatively very good. However, significant improvements need to be made in the supply of electricity, water and sewerage services, the road and other transportation network.

<u>Section 3</u>

There are a number of micro factors which are critical for the viability of Venture Capital in The Gambia. Section 3 examines these micro factors.

The financial vehicle to provide venture capital: the options considered are a specialized Venture Capital Management company and Fund company, an existing commercial bank, a development finance company or a new merchant bank.

A new merchant bank is the recommended option. This is due to its effect on competition, its ability to mobilize local sources of capital, cash flow and synergistic benefits, the staff and corporate culture mentality and its viability. Venture Capital, as one of the products and services of a merchant bank, should be self sustaining without the need for donor funding.

Venture Capital should be market driven, profit driven, and totally private sector funded and managed, preferably local. A merchant bank is a vehicle which should be cash flow positive within the first year of operations and which should fulfil these objectives.

The initial focus of activity of the merchant bank is likely to be money markets, foreign exchange, discounting short term receivables and fee based services. As Venture Capital is management intensive and as numerous changes have to be made to the enabling environment, it is anticipated that Venture Capital will be a second stage activity for the merchant bank.

There are available quality individuals to staff a merchant bank. They will require 1-2 years of training.

There is a sufficient pool of quality entrepreneurs to invest in.

There is a sufficient deal flow to sustain a Venture Capital Unit operating within the corporate finance department of a merchant bank. Note well, the deal flow to sustain this structure is significantly less than that necessary for a specialized Venture Capital company.

Local sources of funding are available to capitalize a merchant bank as well as to invest in Venture Capital on a deal specific basis.

Discounted converted Paris and London Club debts can be another attractive source of capital. This should be explored with the Government, the creditors and IMF. Offshore sources of capital are available, if needed.

Section 4

This section outlines the methodology involved in establishing a merchant bank, the range of products and services which the merchant bank can engage in, the capital required and the shareholding structure, the type of legal structure recommended to provide the Venture Capital investments for specific deals and the estimated time frame and critical path for establishing a merchant bank in The Gambia.

Section 5

Additional service sector opportunities for The Gambia are identified. These are for The Gambia to become a ship registration center (to compete with Liberia) and to be a tax advantageous domicile for foreign corporations.

Section 6

A detailed implementation plan is outlined. It covers the recommendations of the report and suggests meetings with various parties and tasks to be accomplished in Washington DC, other cities in the USA, London, Paris, The Gambia, Abidjan, Nigeria and South Africa.

1. VENTURE CAPITAL

1.1 Define

The essence of Venture Capital is the provision of risk capital and needed skills to entrepreneurs. The process necessitates a very hands on, activist partnership between the Venture Capital Unit and the entrepreneur with the common goal of adding realizable value to the target business/project. Venture Capital is about stimulating private sector entrepreneurship.

1.2 USAID's Role

As in most situations, things only tend to be accomplished when one party with credibility assumes responsibility and "takes the ball and runs with it". By assuming this responsibility, USAID can be instrumental in realizing the objective of fostering private sector entrepreneurship in The Gambia.

Many of the recommendations in this report, relating to USAID, can be incorporated into existing USAID programs. These include:

- FAPE - especially on the enabling environment, the training, educational and skills transfer recommendations
- FSR - for those recommendations dealing specifically with the financial sector
- AVCP - Venture Capital specific recommendations: especially if there is the scope for adapting the methodology to other African countries.

1.3 Gambian Context for Venture Capital

Characteristics of the country:

The Gambia is a tiny sliver of Anglophone Africa surrounded by Francophone Senegal and proximate to other Francophone countries. Due to its size, both physically and in terms of population, as well as the lack of any major natural resources, it is impossible to realize any significant economies of scale unless the target market is the export market.

Economic conditions and policy:

Superficially, the economic indicators for The Gambia are strong. However, upon closer examination, it is evident that these results are dependent on artificial exogenous factors and are not based on fundamentally sound principles and comparative advantages.

This can create a dangerous level of comfort due to the absence of any perceived necessity to plan for the medium to long term. For example, foreign aid is a major source of capital.

The current focus of business in The Gambia is short term. The Gambia is a mercantile economy. Re-export trading is the major lifeblood for the Gambian commercial sector. Yet this form of trading is dependent on artificial exogenous factors which will change. The only question is when. These factors are the overvalued CFA along with price supports and high tariffs in Senegal and other neighbouring countries. When Senegal participates in an IMF program, these price controls will be eliminated.

The current focus of the financial sector in The Gambia is also short term. The commercial banks' activities involve recycling low cost deposits into nonproductive Treasury Bills, foreign exchange and overdraft facilities which are at high real rates of interest, fully secured and hence without risk. The banks provide little secured investment capital, let alone risk capital. Due to the rates of return generated from engaging in this minimal risk activity, it is not surprising that the banks have little interest in providing investment capital. However, the consequence of this is that the financial sector is not playing a productive role in the development of the Gambian economy. The banks are not performing their allocative function of channeling savings into productive investment.

Hence, one may characterize the prevailing focus of Gambian business and the financial sector as "make hay while the sun shines". It is difficult to get investors, bankers and businessmen to think and plan for the medium to long term when excellent returns at little risk are being made in short term activities. The skewing of focus to the short term will have long term negative implications for the development of the country.

This is the challenge facing the Government. It must take the lead in creating an enabling environment conducive to channeling savings into productive investments. Only when the Government takes the lead can we start to see the necessary changes in the enabling environment which will lay the groundwork for facilitating private sector entrepreneurship: Venture Capital.

The Gambia needs to switch from an aid driven, re-export trade focused economy to one based on fundamentally sound investment in the private sector with an export orientation. Indeed, The Gambia is small enough for the whole country to operate as an export enterprise zone.

1.4 What a Venture Capital Unit Will Do in The Gambia

Particularly in developing countries, successful Venture Capital requires an active hands on involvement in the portfolio companies. The role of the Venture Capitalist goes far beyond that of a financier, let alone a fully secured commercial bank provider of term or overdraft finance. The Venture Capitalist is a partner in the fullest sense of the term. Moreover, the skills required are multidisciplinary and hence the need for a team oriented approach.

A venture capital unit in The Gambia will engage in the following activities:

- pro-active identification of opportunities. The Venture Capital Unit will not be reactive waiting for business plans to appear on the desks.
- project/business appraisal
- project/business valuation
- structuring the financing, both in terms of equity, debt and hybrids
- negotiating the deal
- obtaining the financing, particularly mobilizing local sources of capital
- adding value to the project / business and filling the gaps:

  There will always be gaps. A quality Venture Capital Unit will fill those gaps. Typically the gaps will be in one or all of the following areas:

  * financial controls
  * an incomplete management team
  * operational guidelines
  * marketing, especially international
  * international sourcing of raw materials, plant and equipment
  * strategic planning
  * management information systems
  * cost analysis
  * creative financing such as accessing blocked funds, discounted converted Paris or London Club debt.

  To fill these gaps may require one or more of the Venture Capital Unit team members to spend 6-12 months working on the project/in the business:
  - monitoring the investment so that if there is a problem it is addressed at an early stage and if there is an opportunity it is seized.
  - planning an exit mechanism so that the paper gain or loss can be realized. In a country without a stock exchange this is not a particularly easy task.
  - exiting.

1.5 Venture Capital's Context in the Development of the Financial Sector

What we are examining is the scope for institutionalized Venture Capital. Informal Venture Capital already exists in The Gambia as it does in most communities. This type of activity involves an individual providing financial backing to an entrepreneur who lacks the capital. However, informal Venture Capital lacks liquidity and has inherent limitations. Most entrepreneurs need not only capital but also a whole range of skills and services. Therefore, when the term Venture Capital is used, it is in reference to institutionalized Venture Capital.

Venture Capital cannot be established in a vacuum. If one simply sets up a specialized Venture Capital company without taking into careful consideration the surrounding environment, then it is unlikely to succeed. In order to maximize the chances of Venture Capital succeeding, it is essential to understand its place in financial sector development - where it typically emerges at a fairly mature stage - as well as the many macro enabling environment preconditions and micro factors which need to be addressed and satisfied before one can engage in Venture Capital.

One of the main reasons for the relative lack of success of Venture Capital companies in developing countries is the lack of sensitivity and understanding of the importance of the enabling environment and financial sector development. These are necessary preconditions to Venture Capital.

A second factor in the lack of success is the type of vehicle and structure typically selected to provide Venture Capital: specialized Venture Capital companies and Venture Fund Management companies.

These specialized vehicles lack the synergistic and cash flow benefits available to a financial institution (for example, a merchant bank) which engages in a variety of financial products and services, one of which may be Venture Capital. Moreover, they tend to be capitalized primarily with foreign funding, largely donor or multilateral. This tends to create a perception held by investees that the funds received are entitlements rather than an investment with accompanying responsibilities. Mobilizing local sources of capital is essential to viable and successful Venture Capital. Finally, these vehicles typically are staffed with expatriate senior managers who may lack private sector, bottom line oriented, hands on experience while middle and junior management levels tend to be thinly staffed.

The evolutionary stages for venture capital tend to be as follows:

- <u>Government Controlled Credit Market</u>

- <u>Credit Market with Private Commercial Banks</u>

- <u>Foreign Exchange Traders</u>

  At first there tends to be an informal kerb market, then traders and dealers, and then bureau de changes.

- <u>Money Market Development:</u>

  <u>Financial Instruments-</u>

  Initially 91 days and issued by the Government in the form of Treasury Bills with the full guarantee of the Government. Next, additional Government and public sector issuers tap this market (for example, Central Bank, public sector parastatals, State and local government bodies).

  As the confidence level of investors grows, the issuers can start to lengthen the maturities - such as to 180 days and then to 1 year. At about this stage one can expect a few quality bank and corporate issuers (in the form of commercial paper) to tap this market, at least at the overnight to 91 day maturities.

  The strategy at first will be to introduce new financial instruments that provide enough similarities with conventional deposits and loans so as to enable participants gradually to familiarize themselves with the exchange of capital funds.

  Types of instruments include bearer negotiable certificates of deposit and negotiable bankers acceptances. Incentives probably will have to be provided to the commercial banks in order for them to accept without recourse to security, certain categories of bills of exchange drawn by non financial enterprises. One can start with export bills. An incentive could be flexible and guaranteed discountability of such bills by the Central Bank.

  <u>Financial Intermediaries:</u>

  For a money market to succeed there must be liquidity. Financial intermediation in a secondary market provides this liquidity. Therefore, one expects at this stage to see the formation of securities houses, discount houses, money market dealers and brokers.

Market Making Mechanisms:

For a secondary market to develop, an informal Over The Counter (OTC) market is suitable as an initial step to facilitate liquidity.

- Capital Market Development:

Financial Instruments: Equities

At first the main private commercial banks and companies, as well as privatizations of parastatals, are likely to raise equity finance through private placements or public listings. Due to the absence of a secondary market, liquidity tends to be minimal and investors tend to purchase the securities relying primarily on dividend income rather than a capital gain. At this stage, from the investors' perspective, there is not a significant differentiation between this type of equity and a bond instrument.

Financial Instruments: Bonds

As investors become more comfortable with the concept of investing in securities and assuming there is a conducive enabling environment for investors to think medium to long term, issuers will be able to lengthen their maturities beyond those of money market instruments. Initially the maturities will be 1-2 years, then 2-3 years, and so on. Those issuers with the full guarantee of the Government are likely to be the first ones to tap a bond market.

A first step may be bond issues by public sector entities with a full Government guarantee. As an incentive, it will probably be necessary to offer the, for example, 5 year, bonds at a rate which on an after tax basis generates at least a 200 basis points premium over that currently paid on term deposits.

To forestall the risk of capital losses due to future increases in interest rates, it may be advisable to issue bonds at variable interest rates tied to the rate on time deposits, adjusted annually. With the diminished risk to savers and borrowers, due to bond market prices being very close to their nominal value, the term of borrowing gradually can be increased.

Financial Institutions:

At this stage one can expect to see merchant banks and specialized financial institutions such as leasing companies, factoring companies.

Institutional Investors:

A vital ingredient to the development of a capital market is the active participation of institutional investors. Insurance companies, pension and provident fund companies typically are major participants in this market.

Market Making Mechanisms:

At a fairly mature stage of financial sector development, one can expect to see the formation of a formal Stock Exchange.

- Venture/Risk Capital

It is at this point that Venture Capital is most likely to succeed. As a result of a step by step process, local investors are likely to be familiar and comfortable with investing in securities. They will have experienced various kinds of issuers (Government, corporate, financial sector), various maturities (from overnight money market instruments, to 91 day Treasury Bills, to 1 year bonds, to shares) and various types of financial instruments (money market, bonds and equities). Moreover, there will be in place market makers (dealers, traders, discount houses, securities houses, merchant banks), investors (institutional, corporate, individual, financial, Government) and exit mechanisms (an OTC and/or a Stock Exchange).

Where is The Gambia in terms of its financial sector development?

At the time of this report, The Gambia had four commercial banks, four bureau de changes, several institutional investors, 91 day Government money market instruments and some experience with public issues of shares in privatized parastatals and certain major corporate and financial institutions.

What The Gambia does not yet have is: an active money market including an OTC; a capital market; effective mobilization of local sources of capital; efficient financial intermediation; specialized capital market institutions such as discount houses, merchant banks, securities companies, leasing companies; and of course, Venture Capital.

Hence, there is still a lot to be done to lay the groundwork for Venture Capital.

1.6 Critical factors in the Viability of Venture Capital in The Gambia

Macro Preconditions-The Enabling Environment:

- people investment - education and training
- political and economic environment
- government policy towards the private sector, especially investment
- securities market development - money and capital markets
- institutional environment
- legal environment
- prudential regulatory and supervisory environment
- accounting and auditing
- disclosure of material information
- infrastructure environment.

In all these areas, significant progress needs to be made to prepare the groundwork for successful Venture Capital in The Gambia.

Micro Factors:

- financial vehicle, modus operandi, to provide Venture Capital
- availability of quality management to undertake Venture Capital investments
- critical mass of quality entrepreneurs with suitable projects to invest in
- sufficient deal flow
- ability to mobilize local sources of capital
- ability to capitalize a merchant bank and specific venture investments by converting discounted Paris and London Club Debt or other forms of discount investment mechanisms
- ability to access offshore sources of fresh capital, including Islamic funds
- exit mechanisms for the Venture Capital investors to realize their paper gains or losses.

Compared with financial sector development and the enabling environment, many of the micro factors for Venture Capital are already present in The Gambia.

This was one of the pleasant surprises of the Consultant's trip to The Gambia. The factor which clearly is absent is that of exit mechanisms.

1.7 The Need in The Gambia for Venture Capital

In examining the need in The Gambia for Venture Capital the following issues should be considered:

How well is the credit market - the commercial banks - serving the needs of Gambian entrepreneurs?

The commercial banks tend to lend, when they do, short term and fully collateralized with physical assets. There is minimal, if any, cash flow based lending and no pure risk capital investment based on management and growth prospects. Commercial banks tend to be risk avoiders and asset intensive. Yet the essence of Venture Capital is risk capital and a hands on involvement with management in all facets of the business. This situation prevents many young companies, which may not as yet have acquired many physical assets, from obtaining term finance. With established companies the cost of borrowing from the banks, in terms of real interest rates and the hidden costs, is prohibitively expensive for all except those companies which are engaged in the short term oriented and highly profitable re export trading activities.

Consequently, Gambian companies are underleveraged as they primarily have to rely on retained earnings and to a limited extent on overdraft facilities for their capital needs.

In contrast with commercial banks, merchant banks are management intensive and their security analysis places greater emphasis on cash flow, growth prospects and management. To this extent merchant banks have a greater willingness to accept and assess risk rather than to avoid it. Therefore, as an institution they are better suited to engaging in Venture Capital than the commercial banks.

Other potential sources of term finance were the former development finance institution, The Gambia Commercial and Development Bank (GCDB) and the IBRD Apex facility.

The IBRD Apex facility has been unused. This is no surprise as the interest rate charged to the commercial banks to access the funds is relatively high (3% below the Treasury Bill rate which is currently 17.5% when the banks' average cost of funds is only 8-9%) while at the same time the banks have to assume the full credit risk without recourse to the Central Bank or the facility.

Therefore, Gambian entrepreneurs do not have access to term finance let alone Venture Capital. Apart from the value added services provided by a Venture Capital Unit, equity risk capital relates risk and return more accurately than debt which through interest imposes on the borrower fixed recurrent costs.

There is no shortage of entrepreneurship in The Gambia. The fact that The Gambia is a thriving entrepot center for trading of both physical goods and currencies and is awash with money, is testament to the entrepreneurship of the Gambians. Given the lack of natural resources, The Gambia survives through the initiative and resourcefulness of its people and the donor community.

There is clearly a need for Venture Capital. Informal Venture Capital takes place in the form that many successful Gambian entrepreneurs have silent private partners as financial backers. The need to resort to these informal channels is due to the formal financial sector not providing risk capital and term financing to entrepreneurs.

The difficult issue is determining how to provide Venture Capital in a viable manner so as to maximize the benefits and to avoid another GCDB-Like situation. This is why it is so important to engage in a step by step process to lay the groundwork for Venture Capital. Ultimately, Venture Capital will only work with significant local investor participation. Venture Capital funded by foreign capital, especially if it is aid linked, will likely be perceived by many investees as Grant rather the Loan Funding.

Money and aid is not what is needed. What is missing is an efficient mechanism of financial intermediation along with a supportive enabling environment to mobilize domestic sources of capital and to channel it into productive investments.

Hence, in addressing the viability of Venture Capital, one has to first address financial sector development and the enabling environment.

1.8 What investors Look For

The enabling environment is vital to the concerns of the investor (both foreign and local) and to the entrepreneur/investee.

Key elements in the decision making process for investment:

- stable political and economic environment
- open, laissez faire government
- transparency in decision making with little systemic corruption in dealings with Government and the banking system
- ability to get things done: the hassle factor
- incentives for investors - such as the ability to capitalize the venture via discounted debt or blocked funds or a preferential exchange rate for investors
- foreign exchange which is market driven
- ability to remit profits

- minimal risk of nationalization
- low taxes, duties, charges, fees
- quality and relative cost of labor and skilled management
- availability of land and premises at competitive rates
- access to sources of supply
- sources of local financing at attractive rates
- size of the domestic market
- access to sales markets
- transportation costs and efficiency level.

1.9 <u>The Gambia's comparative advantages for investment</u>

- stability
- open and accessible government
- the allocation of foreign exchange is market driven without government restrictions
- an entrepreneurial workforce
- suitability for labor intensive, low skilled, light manufacturing, processing and assembly operations geared for the export market.

1.10 <u>The Gambia's comparative disadvantages for investment</u>

- size of market
- short term focus of business and the financial sector
- lack of a money or capital market, including a vehicle to provide risk capital
- high real interest rates (15-20%) and little availability of term finance
- labor skills shortages - especially at the middle management level
- relatively low level of labor productivity compared with workers on similar wage rates in countries like Kenya, Ghana, Vietnam, China, Bangladesh, Guatemala
- lack of international marketing skills and knowledge
- lack of infrastructure
- few natural resources
- high transportation costs - to and from The Gambia, air and sea - and unreliable service
- few tangible incentives under the current Development Act to attract foreign companies to invest in The Gambia.

1.11 <u>Strategy for successful Venture Capital in The Gambia</u>

What is required is a step by step process which will focus on:

- addressing the recommendations concerning the enabling environment
- financial sector development
- establishing a merchant bank which will engage in a variety of activities, one of which will be Venture Capital.

Venture Capital will be part of the corporate finance department and probably a second stage service for the merchant bank. It is anticipated that the merchant bank will initially focus on activities such as money markets, foreign exchange and fee based services. In its set up phase it will be difficult for the merchant bank to allocate management time to Venture Capital. Only in the post start up phase will there be the resources available for Venture Capital, which is of itself very management intensive.

- Venture Capital will focus on The Gambia's assets:

  * labor intensive activities
  * low skilled light manufacturing and processing or service oriented businesses
  * production targeting the export market.

Due to the size of the country, the stability of Government and its people, there is a better chance of successfully developing Venture Capital in The Gambia than in many other countries.

The Gambia has the potential to be a model for other developing countries.

2. MACRO PRECONDITIONS - THE ENABLING ENVIRONMENT - INFLUENCING THE VIABILITY OF VENTURE CAPITAL IN The Gambia

2.1 Investing in people

This is an essential element to Venture Capital as one is ultimately investing in people, not projects; the investors are people, not institutions; and those managing the investments are people, not banks or NBFIs. It may seem obvious. However, the emphasis on people - the investment in their training and education - cannot be overstated.

Investment in education, training and skills acquisition lessens this risk as well as leveraging the funds invested as those who are now educated and skilled can then teach others. This also helps developing countries become self sufficient and break out of the dependence on aid and foreign consultants.

In The Gambia the human talent is available. What the labor force and management need are skills and training.

Education and training shall be targeted at the following groups:

- management of a merchant bank
- management of other financial institutions, including institutional investors
- entrepreneurs
- investor public
- government
- regulators, supervising, monitoring and enforcement agents
- NIB
- the workforce of today and tomorrow.

Recommendations concerning education:

- Invest significant resources in primary, secondary and tertiary education. The adult literacy rate in 1990 was only 27%. It will be money well spent.

- Conduct a public education campaign regarding investment, securities, risk capital and the potential for gains and losses. This is critical to any effort to mobilizing local sources of capital.

- Qualified financial journalists are also a key element to public education and to enable potential investors to make informed decisions.

- Computer literacy is vital for development. Establish a not for profit corporation which will solicit from American corporations and individuals tax deductible donations of computer hardware (for example, 286 PCs). This hardware will be donated to schools throughout The Gambia, as well as to other countries. Technicians will be required to service and repair the PCs and to train Gambian technicians. Computer science teachers from America can come to The Gambia as part of a Jobs Corps to teach Gambian teachers so that they will in turn be effective teachers of computer skills. Private sector models include the East West Exchange.

- Provide scholarships for talented Gambians to study in American colleges business and technical fields.

- Establish technical apprenticeship schools teaching skills geared to specific employment opportunities.

- Establish in The Gambia a tertiary school for entrepreneurial development. One way of setting it up is to identify an American school which has a successful School for Entrepreneurial Studies (eg the National Foundation for Teaching Entrepreneurship (NFTE) based in New York City) and to adapt the curriculum to the local Gambian needs and conditions. The Management Development Institute (MDI) is poorly suited as it has been geared to teaching middle level management of public sector entities. Success in the private sector requires a different mentality and skills. The instructors at MDI are unlikely to have the skills for teaching entrepreneurship. For the first 5 years, until local Gambians are qualified, the teachers will be academics on sabbatical from American schools for Entrepreneurial Studies as well as retired successful executives and entrepreneurs. One African success story in this area is the Malawian Enterprise Development Institute (MEDI). MEDI provides vocational training in business management and entrepreneurship. MEDI can be a model.

- Help to establish regional based business schools with a curriculum adapted to the particular needs and conditions of specific African countries. Locations include Accra, Abidjan, Harare, Johannesburg, Nairobi. In terms of finance, the focus will be on securities market skills and analysis. MDI is likely to be unsuitable due to its focus on the public sector. These schools also will initially be staffed with academics on sabbatical from American colleges. In time there will be a pool of African academics with these specific skills.

- Establish in The Gambia the Chartered Financial Analyst Program (CFA). This is an excellent program especially for those individuals who are going to participate in a securities market.

- Help to establish an African based professional training school for Government regulators as well as supervising, monitoring and enforcement agents. As with the business school, the curriculum will be adapted to the particular environment of specific African countries. The West African Insurance College in The Gambia, for middle management, can be a model.

Courses initially will be taught by academics on sabbatical from leading programs of this nature in other countries (for example, the SEC, Federal Reserve, Comptroller of Currency, NASDAQ, IRS, Customs).

Types of government regulators and agents include:

* Banking supervision department of Central Bank
* Office of the Commissioner of Insurance
* Securities Markets Authority
* Customs and Excise
* Revenue/taxation department.

Recommendations concerning training:

- Send management staff of a merchant bank for practical training:
  - Internally on the job, provided by the foreign technical partner, the APDF officer in charge of the team of analysts for the Venture Capital Unit, African Management Services Co. (AMSCO), International Executive Service Corps (IESC), or Centre for Industry and Development (CDI - based in Brussels).
  - Externally, by placing the management staff with other African financial institutions which have expertise in the specific financial product or service.
  - Externally, by placing targeted Gambian staff for the Venture Capital Unit with a quality Venture Capital firm, preferably successfully operating in Africa, or alternatively a Venture Capital firm in America which has interest in and experience with international Venture Capital in emerging markets.

- Send regulators, supervising, monitoring and enforcement agents for practical training in other African countries where these Government agencies are well established and operating effectively.If specific agencies are not available in African countries then look at certain Asian countries such as Indonesia, Philippines,Thailand, India, Sri Lanka.

- Send staff of the National Investment Board (NIB) for training in project appraisal analysis as well as pre and post investment marketing.

Recommendations concerning skills transfer programs:

- Help to establish and promote MBA internship programs with Gambian companies. A key constraint for many Gambian entrepreneurs is the difficulty delegating responsibility due to local skill shortages. MBA students with analytical skills can spend 6-12 months with a Gambian entrepreneur. There currently are 2 Columbia University MBA students with Moukhtara Holdings and NPE Seafoods. It is a mutually beneficial experience.

  Programs of this kind can be promoted directly or indirectly by supporting organizations which are trying to do this. Two such organizations are the MBA Enterprise Corps and Access Africa Enterprise Corps (AAEC). The former was founded in 1990 by 15 top American business schools and so far has focused on Eastern Europe and Southeast Asia. AAEC presently is sending some MBA students to Ghana as a pilot program.

Recommendations concerning business development programs:

A key constraint for Gambian entrepreneurs is their lack of international marketing and sourcing skills and knowledge.

- Send Gambian entrepreneurs overseas to visit relevant trade and industry shows in America. Benefits to the Gambian entrepreneur include making contact with:

  * American suppliers of plant and equipment, raw materials
  * American marketing agents, distributors, wholesalers and potential importers of Gambian products
  * Potential American technical joint venture partners for Gambian projects.

  Additionally, through attending seminars at these shows, the Gambian entrepreneurs will become familiar with the latest developments in their particular field of business.

- Provide grants or low interest loans to cover the cost of feasibility studies for Gambian projects which show a high degree of commercial viability and where the Gambian entrepreneur has clear comparative advantages for developing this project: that is, the right project matched with the right entrepreneur.

- Organize visits of foreign businessmen (preferably American), rather than academic consultants, to The Gambia. The purpose will be to identify opportunities, to prepare their own feasibility studies and then act on the identified opportunities. The businessmen will be pre-qualified. In particular, traders with marketing expertise in specific Gambian products with export potential (Julian from Kenya regarding sesame seeds is an example) as well as companies with expertise in owning and operating businesses that have potential in The Gambia for generating exports should be targeted.

Recommendations concerning the Gambian diaspora:

- Identify, with the assistance of the Gambian embassy, talented Gambians studying or working overseas. In America there are 200-300 Gambians studying. Many do not return. This is a significant brain drain. An active private sector development program will create many opportunities for these Gambians and may encourage them to return home to participate in building the future.

  If they knew of opportunities, such as management positions with merchant banks and other specialized capital market oriented financial institutions, or the availability of financing to establish their own businesses, then many will be keen to return. It is the lack of opportunities at home which keep many abroad.

2.2 Political and economic environment

Political risk / stability:

Without an established period of political stability as well as the perception of continued political stability, it is impossible to expect investors to think in the medium to long term as far as providing risk capital. Nor can one expect businessmen to plan beyond the short term.

A significant positive for The Gambia is its relative political stability. Since independence there has been only one coup attempt, unsuccessful and over a decade ago. Nor has The Gambia experienced significant tribal conflicts.

Macroeconomic policy:

As a general comment, since the reform program of 1985 the Government of The Gambia has removed many of the distortions in the macroeconomic enabling environment. Nevertheless, in so far as Venture Capital is concerned, much remains to be done.

Monetary Policy

Credit:

The government does not have credit ceilings or other restrictions on the granting of credit by financial institutions. This is a positive factor.

Open market operations (OMOs):

OMOs should be the prime means by which the Central Bank influences the reserve levels of financial institutions. An active OMO will be a major catalyst for developing the money market. Through the purchase and sale of Government securities (such as Treasury Bills) the Central Bank can soak up or expand reserves in the banking system. This has a flow on effect on the capacity levels of the banks to lend and therefore effects the money supply. Central Bank involvement in a money market through OMOs can be an important guide for monetary policy. Yields in the money market reflect the current relationship between credit supply and credit demand as well as the realistic levels for interest rates.

Recommendation:

Encourage the Government, especially the Central Bank, to utilize OMOs as the primary means by which they will influence the reserve levels of financial institutions.

Reserve requirements for financial institutions:

Recommendation:

Encourage the Central Bank to adopt a tiered rate structure depending on the type of activity and the effect on the velocity of money and therefore the money supply.

Hence, a financial institution engaging in term finance and Venture Capital will have lower reserve requirements than a money market discount house which will have a greater impact on the velocity of money.

Interest rates:

A money and bond market in which interest rates are freely determined by supply and demand factors provides the Government with a timely indication of overall credit conditions. At the moment there are very high real rates of interest on loans (15-18%). The spreads between lending and deposit rates are also very high (10-15%). In 1991 the margins were 16-19%. These compare with 4-6% in developed countries and 7-13% for most developing countries. The margins in The Gambia are among the widest in Africa and the world. This is largely due to the lack of competition in the financial sector. This will change and has already started to change. Interest rates have started to fall although the spread has remained the same. With new financial institutions entering the market, competition will increase and the spread should narrow significantly.

Recommendation:

- Lending rates have to come down to between 10-15%. Lending rates of 21-26% when inflation is in the range of 10% are prohibitively high for business and necessitate particularly high hurdle rates of return for risk capital. This in itself is a major constraint for investment.

  Government can take the lead through OMOs and by indirectly lowering the Treasury Bill rate (currently 17.5%) as well as the Discount and Rediscount rates (currently 20.5%). Now that the Government has met the IMF recommendation of foreign reserves amounting to at least 5 months worth of imports, it is hoped that there will be a reduced need to maintain Treasury Bill interest rates at the 17-18% levels.

Fiscal policy

Taxation:

Incorporate, if possible, the following recommendations as part of the FAPE program and the work of Amex International. These recommendations are designed to make The Gambia more attractive for investment, especially equity investment in the form of risk capital as compared with debt financing.

Recommendations:

- Lower tax rates for both individuals and corporations.

  For example, the corporate tax rate is anticipated to be reduced to 35%. Yet it is worth considering lowering to 25%. In tandem with lowering the tax rates, it is equally important to increase the transparency of taxation and to significantly increase the collection of taxes. If these three recommendations are implemented, the effect is likely to be a revenue gain for the Government as the increase in transparency and collections should significantly outweigh the revenue effect of reductions in tax rates.

  One can increase the transparency of taxation by eliminating many of the available deductions and other areas of arbitrariness.

  It is vital to increase the collection rate of taxes, especially income and corporate. At present only four companies pay taxes in The Gambia with 80% of the tax revenue coming from indirect customs duties and sales taxes. In order to accomplish this objective, it will be necessary to significantly increase the resources of the taxation department in the areas of trained staff for collecting and auditing, computerization and automatic payroll tax deductions.

- Eliminate the bias against dividends compared with interest, including the double taxation of dividends.

  If a priority of Government policy is to stimulate investment, then this should be reflected in the tax policy concerning equity investments as opposed to debt financing.

  It is one thing to remove the tax bias against equity investment. The next issue is to consider a tax incentive for those who invest in equities as opposed to debt. This is critical as in The Gambia investors in equities tend to focus more on the dividend rather than the potential capital gain.

As a comparative example, Ghana lowered the withholding tax on dividends from 30% to 15%.

- Substantially lower the capital gains tax and have a sliding tax rate scale which reduces over time as the asset is held. In terms of securities, ensure that the tax rate is low enough so as not to discourage a secondary trading market. As a comparative example, Ghana lowered its capital gains tax from 55% to 5%.

  The capital gains tax is a key element in fostering or impeding Venture Capital. It increases in importance with the investor as the opportunities for selling the asset for a capital gain increase in time as securities markets develop thereby providing liquidity and exit mechanisms.

- Eliminate the minimum turnover tax.

  At the moment, there is the theoretical situation of a company which has no income in a certain tax year but is still assessed a tax. By increasing accounting and auditing requirements as well as the resources of the taxation department, both quantitatively and qualitatively, the department will have the capacity to assess taxes on companies, rather than rely on the minimum tax based on turnover provision.

- Provide tax incentives for investors in Venture Capital deals, especially in designated priority pioneer projects. These incentives are designed to offset decreases in the possibilities for tax evasion as the investors will be participating in a limited liability company which will be audited and where the income stream to the shareholders will be transparent. It should be noted that if the recommendations concerning transparency and collection of taxes are implemented, then the scope for tax evasion will be significantly reduced system wide.

- Provide tax incentives for investors in public securities to offset decreases in possibilities for tax evasion.

- Provide tax incentives for companies to go public to offset decreases in possibilities for tax evasion. For example, there can be a two tiered corporate income tax structure: one level for those companies that are closely held and privately owned; another lower level for those companies which have various degrees of public ownership.

- All imported inputs which will have local value added and then the finished product is exported should come in duty free and be kept in bonded warehouses.

- Import duty rates should be lower for inputs which have local value added and then are sold on the local market compared with import duty rates on the competing finished product - for example, candy.
- Waive all duties on imported plant and equipment which are to be used in businesses whose value added output is exported.
- Gambian companies should be given financial incentives or tax credits for training their employees and enhancing skill levels.

<u>Foreign Exchange</u>

In The Gambia the allocation of foreign exchange is determined by market forces. There are no restrictions on the purchase and sale of foreign exchange. This is a major plus for The Gambia in terms of foreign investment.

Recommendation:

Government should allow dollar domiciliary accounts to be opened.

<u>Inflation</u>

Inflation in The Gambia is relatively low at around 10%. However, as recently as 1985, inflation rates were in the 50% range. If investors believe that the return to high rates of inflation is possible in the near future, then this will be a major impediment for Venture Capital. People will not be willing to lock in funds for the medium to long term if a return to high inflation can wipe out income and capital gains in real terms. Under this scenario, the desire of investors in a time of uncertainty will be to maximize liquidity. Investing in Venture Capital is the opposite to maintaining a liquid position, especially in a market where the exit mechanisms are limited. This is one reason wh a stable macroeconomic environment is vital for Venture Capital.

2.3 <u>Government policy towards the private sector, particularly investment</u>

Investment policy:

This is critical to Venture Capital. Government must take the lead by setting a policy which is actively pro private sector, pro investment and pro Venture Capital.

Recommendations:

- In general, there needs to be a laissez faire approach to investment.

- Government should articulate a clearly defined investment policy which recognizes that The Gambia is competing in a world market for investment.

  Hence, in order to attract investors, tangible incentives must be provided and a conducive enabling environment created.

  Government investment policy must be a catalyst for mobilizing domestic and foreign sources of capital and to channel it into productive investment opportunities. The National Investment Board (NIB) is key to this objective.

- Scrap the Development Act and replace it with an "Investment Promotion Code".

  This legislation will:

  * be transparent and minimize the arbitrary aspects of decision making
  * have significant and tangible incentives for investors
  * remove administrative bottlenecks by streamlining and centralizing decision making, approval and licensing processes.

    It can take from 3 months to 3 years to obtain a Development Certificate as many Government Ministries, agencies and Cabinet participate in the decision making. To take up to 3 years to get a decision is simply too long for investors.

2.4 Securities Market development

At present there is no securities market in The Gambia as the commercial banks, acting de facto as a cartel, dominate the financial sector.

Function:

Securities markets typically perform the following functions:

- Mobilize domestic savings:

  This is vital as it will increase the indiginization of investment thereby reducing the dependence on donor financing. The Gambia is not short of money or liquidity. What is missing is a mechanism to efficiently mop it up and reinvest it. The commercial banks are not performing this function. A securities market would.

The mobilization of savings will increase the number of Gambians who are direct shareholders in Gambian companies thereby diversifying the direct ownership of the country's assets. The more the citizens of a country have a direct equity stake in assets of the country, the greater the likelihood of political stability.

- Increase the efficiency of channeling savings into productive investment:

  This is a result of securities markets:

  * creating financial deepening via more competition
  * reducing the costs of financing as a result of increased competition
  * increasing financial intermediation, especially via the development of secondary markets.

    This is essential to providing liquidity and demonstrates a fundamental difference between the credit market and the securities market. In a securities market the financial instruments are negotiable and can be traded in a secondary market.

  * generating a more intensive use of cash balances by bringing together those who have cash surpluses with those who have cash deficits
  * providing exit mechanisms for realizing capital gains and/or losses.

- Diversify the means by which the private and the public sectors can raise and invest funds.

- Provide a means for valuing investments and divestitures.

- Strengthen corporate balance sheets through equity investment, improve long term to short term debt ratios and lessen dependence on evergreen overdraft financing.

- Facilitate through fine tuning, the Government's conduct of monetary policy.

- Encourage entrepreneurship through providing risk capital.

Need for a Securities Market:

To assess the need for a securities market, one should address the following issues:

Do the range of products and services offered by existing financial institutions meet market demands?

The answer is "No".

Is financial intermediation provided at a reasonable cost?

The answer is "No".

For the financial intermediation which does exist, the spread between the banks' cost of funds (on average 8-9 %) and their lending rates (on average 21-26 %) is extremely high taking into account an inflation rate of less than 10%. Lending - even overdraft financing -tends to be done on a fully secured basis. This limits the amount of financing that companies can access, irrespective of the cost.

Is there a healthy level of competition between financial institutions?

Clearly "No".

An example of the lack of competition is the ability of the banks to generate significant revenues from fees which would not be possible in a competitive environment.

Are the existing commercial banks effectively mobilizing domestic sources of capital?

The answer has to be "No".

The commercial banks have a minimal presence outside the Greater Banjul metropolitan area. Moreover, the banks sometimes take measures the effect of which is to discourage deposits. For example, Standard Chartered Bank Gambia, Ltd. puts a ceiling of 50,000 Dalasis per savings account and a minimum amount to open an account of 500 Dalasis (the equivalent of 30 days wages for an unskilled worker - not an insignificant amount). Moreover, it can take 3 months to open up a Term Account at Standard Chartered Bank Gambia, Ltd. In the meantime, funds sit in a non interest bearing demand account.

Hence, one can conclude that there is a present need in The Gambia for a securities market.

Mode of developing the Securities Market:

There are generally two approaches:

- A universal banking approach, as with Germany and Japan
- Specialized financial institutions, as in America.

Comparative data tends to show that countries which have taken the specialized route have deeper financial markets, a higher level of competition and lower intermediation costs. A caveat is the fact that in many areas The Gambia is too small a market to sustain a specialist financial institution engaged in a single activity.

Recommendation:

Out of practicality, it is likely that financial institutions will need to engage in a variety of activities in order to be viable.

Synergistic and cash flow benefits can also be derived from engaging in a variety of financial products and services.

Money Market:

Developing the money market is normally one of the first steps to diversifying the financial sector beyond a purely credit market - commercial banking - system. At the moment there are 91 day Treasury Bills, Central Bank Bills and Groundnut Bills. There are no other issuers, no longer maturities (the exception being the Groundnut Bills) and no interbank market.

The money market is not necessarily a direct competitor with the commercial banks, even though the commercial banks can be disintermediated. Indeed, it should be an important vehicle for the commercial banks to manage their money positions.

By allowing for a more intensive use of available bank reserves, the money market will enhance the ability of the commercial banks to allocate funds efficiently. Commercial banks are potential major participants in a money market.

Recommendations:

- The Central Bank should start to lengthen the maturities of Treasury paper so that a tiered interest rate structure can develop.

  The next step is to diversify the range of money market issuers beyond the Government, to include certain public sector entities, quality companies and the banks themselves. In order to encourage a secondary market trading in these instruments through financial intermediaries, holders of Treasury Bills should be permitted to trade their positions freely without going through the Central Bank.

- Legislation and regulatory guidelines concerning the money market need to be drafted and enacted.

- The Government should encourage the licensing of suitably qualified issuers, traders and dealers in these instruments. These would include merchant banks, discount houses and securities companies.

Capital Market:

The development of a capital market normally follows the development of a money market.

The two basic classes of capital market financial instruments are bonds and equities.

Recommendation:

Initially, the focus should be on developing the money market. The second stage in this step by step process will be to develop the capital market.

2.5 Institutional environment

Credit sector - the commercial banks:

There are four commercial banks in The Gambia and several commercial banking licence applications pending approval. Standard Chartered Bank Gambia, Ltd. has been in The Gambia since 1901. BICI, a subsidiary of a Senegalese Bank which itself is a subsidiary of BNP of France, has had a presence in The Gambia for many years. Meridien Bank Gambia, Ltd. opened in 1993 having acquired certain assets of the now defunct GCDB. The fourth commercial bank, Continent Bank, is operating but has been mired in legal actions concerning their banking licence.

With the failure of GCDB, none of the commercial banks are majority government owned and none are majority Gambian owned. Yet there is available the local capital and talent to establish and manage an indigenous Gambian financial institution.
The commercial banks dominate the financial system. Competition is relatively low and the emphasis is not on servicing the needs of customers as the banks up until now have had a guaranteed captive market.

In terms of profitability, the commercial banks are generating exceedingly high returns given the amount of capital utilized and the risk return profile. The two established commercial banks, Standard Chartered Bank and BICI, have generated over the years extraordinary levels of profitability. Returns on assets tend to be in the 10-13% range while returns on equity range from 70% to 140%. These are among the highest ratio returns for commercial banks anywhere in the world. The banking sector is extremely profitable and given their activities, low risk.

Even though the commercial banks are highly profitable, there still is systemic credit market financial instability due to maturity mismatching: short term deposits which are onlent in the form of credit lines and overdraft facilities that are in practice evergreen. The desire to avoid such a maturity mismatching may be one reason for the low level of term financing and the relatively high level of Treasury Bill purchases by the commercial banks. A securities market, by developing new financial products as well as financial intermediation, will help to arbitrage out this maturity mismatch risk.

Non Bank Financial Intermediaries (NBFIs) - the Foreign Exchange (FX) Bureaus:

There are presently four bureaus de change. Two more have been granted licences but are not yet operational.

For traders, owning a bureau de change reduces the foreign exchange costs to pay for their imports. It is yet another means by which the commercial banks can be disintermediated.

Recommendation:

The bureaus de change should be encouraged as they will eventually soak up the kerb market, thereby assisting the Government in its execution of monetary policy. Moreover, they provide competition to the commercial banks in foreign exchange.

Contractual savings organizations:

The dominant contractual savings organization is the Government owned Social Security and Housing Finance Corp. It has a monopoly on providing pension and provident services, already is an institutional investor and has the capacity to be a major investor. In addition to this public sector entity, there are a number of private insurance companies. However, a significant percentage of the insurance companies are not financially sound.

Recommendations:

- There is an urgent need for prudential supervision and regulation as several insurance companies are presently insolvent.

If any of the insurance companies went into bankruptcy and liquidation then it would seriously weaken the public's trust and confidence in financial institutions.

At the moment there is not even an independent and staffed Office of the Commissioner of Insurance. This must be rectified as soon as possible.

Healthy private insurance companies should be allowed to compete with Social Security and Housing Finance Corp. to provide life insurance or pension plans to government employees.

Pension and provident plans represent the largest sector of the Gambian insurance market and yet the private insurance companies are denied access to this market.

This is potentially to the detriment of the general public which could benefit from competition in the provision of insurance, pension and provident services.

There should be clear regulations as to the ways in which insurance companies can invest their assets.

At present, the guidelines are vague and ill defined. This is a dangerous situation, especially as the public trust is at stake.

The regulations should be risk adjusted and should set parameters within which the contractual savings organizations can invest their assets.

It is recommended that a maximum of 10% of the assets can be invested in Venture Capital situations, providing such investments are managed by a pre approved financial institution with expertise in this area - for example, a merchant bank. It is recommended that the minimum level of assets which need to be invested in Government securities should be 25%, not the current 75% which is too high. On the other hand, insurance companies presently have no restrictions on the remaining 25%. This too is inappropriate.

Provisions should be made for other investments including real estate, money market instruments other than Government securities, bond instruments and equities as a portfolio investor as opposed to Venture Capital.

Money and Capital Market institutions:

Money market dealers and traders

These players are essential for financial intermediation and liquidity. They also are important to the Central Bank's ability to fine tune monetary policy through OMOs.

At present there are no such dealers and traders.

Recommendations:

- In order to have liquidity in a secondary market for securities, such as an OTC, it is critical to have at least 3-4 dealers and traders.

  These could be one of the bureau de changes, a specialized discount house, Meridien Bank and a merchant bank.

- The Central Bank should provide a rediscount window to dealers and traders in government paper.

Merchant banks and securities companies

At the moment there are no merchant banks or securities companies. Yet there is a need for these financial institutions.

Recommendation:

- Create at least one merchant bank and one discount house.

  There should be at least two underwriters of securities in the primary market in order to have a level of competition.

  Meridien Bank International has expressed some interest in developing certain merchant banking products and services.

Stock exchange

There is a need in The Gambia for a stock market. The absence of this exit mechanism is a significant impediment to investors in Venture Capital. However, a stock exchange is unlikely to be viable if it is purely a Gambian entity. The local Gambian market is too small to sustain a stock exchange.

What makes things difficult is that the neighbouring countries are Francophone with different legal systems, company codes and regulations. Hence, a regional exchange is not a simple matter. Yet that is probably the only way in which such a stock exchange can be viable and attain the critical mass of listings and financial intermediaries.

In The Gambia there are an insufficient number of eligible companies which could list in order to sustain a stock exchange. One requires at least 20 companies, each with a float of at least 25% of their capital, which are available for trading their securities in a secondary market.

What is also absent are financial intermediaries, for both the primary and secondary markets. There should be at least 2 financial intermediaries and preferably 3-4.

Recommendation:

A stock exchange in The Gambia is not viable in the short term.

In the medium term, Gambian companies may be able to list on a regional stock exchange based in Dakar, Accra, Abidjan and/or Lagos. However, first the gulf between Francophone and Anglophone West Africa must narrow.

Over the Counter Market (OTC) for unlisted securities

An OTC is presently feasible in The Gambia. It should be one of the first steps in developing the securities markets. In time, a stock exchange on a regional basis may be viable.

It is believed that there are a sufficient number of companies whose shares could be traded on an informal OTC to justify the viability of an OTC.

Recommendations:

- An OTC should be established. It is hoped that IFC will provide technical assistance.
- Initially the OTC could be monitored by the Central Bank with dealers registered with the Central Bank. In time a self regulatory authority would supervise the OTC.
- At first the OTC is likely to focus on trading Treasury Bills, other Government paper and shares of public companies.

Export Credit and Insurance Program

As The Gambia's future lies in developing its export base, a vital institutional element to this strategy is to establish an export credit and insurance program. This will include pre and post shipment finance to Gambian exporters and will insure Gambian banks providing export finance.

Recommendation:

Establish an export credit and insurance program.

USAID, coordinating with Eximbank and OPIC, could assist in this. As with Ghana, this program could tie in with an IBRD Export Credit Rediscount Facility.

2.6 Legal environment

Legislation can be an incentive or an impediment for Venture Capital development. What is needed is to examine existing legislation to identify the impediments and where needed, to draft new legislation which is necessary for securities market development.

Existing legislation:

Recommendations:

The following should be investigated:

- Financial Institutions Act:

  Ensure that there are no restrictions on:

  * provisions to cover merchant banks
  * provisions to cover NBFIs
  * merchant banks engaging in Venture Capital activities which will entail taking equity positions in companies.
  * Islamic banking and financial services

- Companies Act:

  Ensure that there are:

  * no prohibitions on negotiating financial instruments. Any restrictions of this kind are a major impediment to developing secondary markets for securities.

  * no restrictions on securities underwriting
  * regulations covering mergers and acquisitions

- Insurance Act:

  Risk adjusted investment parameters need to be set for allocating insurance companies' assets.

New legislation:

Recommendations:

° Money and capital markets legislation:

There is no legislation of this kind. Part of the process for developing the securities market is to draft appropriate legislation.

The legislation would cover issues such as:

* listing requirements
* requirements of a public offering
* procedures regarding prospectuses
* purchase and sale of securities
* regulations for prudent investments by institutional investors based on diversification of risk asset type and maturities, including equities as allowable assets
* requirements for trading in secondary markets
* requirements for intermediaries
* requirements for transfer, clearing and settlement
* information disclosure
* accounting and auditing
* market supervision
* penalties and other disciplinary actions
* requirements for credit in relation to securities

° Bankruptcy legislation:

There is a need to streamline foreclosure and bankruptcy procedures.

2.7 The Legal process

One aspect of the legal environment is the legislation. Another aspect is the legal process.

Judicial independence, the ability for an applicant and a respondent to have a hearing in a timely manner and the capability to enforce judgements, are important elements in private sector development.

If people or companies do not have confidence in their abilities to exercise their legal rights, then this negatively impacts potential investors (local and especially foreign) and commercial development.

The legal process is a constituent element to creating an enabling environment conducive to private sector investment.

The court system:

It is essential for applicants to be able to obtain from the legal system judgements in a timely manner and without third party influence. This is not presently the case in The Gambia.

Recommendations:

- Ways to improve the process include establishing specialized commercial and bankruptcy courts which will have the power to both decide cases as well as to exercise judgements.

Enforcement of judgements:

The ability to enforce judgements and to exercise collateral, including the right of foreclosure, is an important element to the enabling environment for investment.

Recommendation:

There is no easy solution to this problem. What can be hoped for is that over time, a professional and independent judiciary and bailiff system will develop a greater respect for the law.

If individuals believe that the legal system will provide a fair hearing in conjunction with an independent judiciary, then there is a greater chance that the legal process will be relatively transparent, or at least translucent, and that judgements can be enforced in a timely manner.

2.8 Prudential regulatory and supervisory environment

Governing regulatory and supervisory bodies are also important elements in the enabling environment.

For a country as small as The Gambia, there have been a large number of bank failures, including the granting of bank licences to applicants who subsequently proved not to be fit and proper to hold a licence.

That is why it is so important to allocate resources at this level as it can save potentially very significant costs to The Gambia down the road.

Hence, resources allocated to adding skilled manpower to this department will be money well spent.

Recommendations:

- Banking supervision should be organized into two functional areas. One is the evaluation of applicants for a bank licence. The other is the ongoing monitoring of those holding banking licenses.

- Staff training, including bank examiner skills, is vital.

- Tighten the evaluation process for bank licenses.

  There must be clear and stringent guidelines to determine whether promoters of a potential new financial institution are fit and proper to receive and keep a banking licence.

- Implement risk adjusted/weighted capital requirements for financial institutions.

- Focus on quality of assets:

  * interest should be booked when paid, not automatically on an accrual basis
  * regulations should be established for the adequate provisioning of doubtful debts
  * non performing loans should be provisioned for and not simply rolled over
  * interest should not be capitalized - that is, loans should not be provided to cover unpaid interest.

- Set lower liquid reserve requirements for a merchant bank compared with a commercial bank.

  Since merchant banks tend to engage to a significant extent in advisory fee based services and to some extent in medium and long term financing, there is less of a need for high liquid reserve requirements compared with commercial banks.

  These activities have less of an effect on the velocity of money and therefore the money supply, compared with the current activities of the commercial banks.

Office of the Commissioner of Insurance:

At present there is no Office of the Commissioner of Insurance. The Ministry of Finance is performing this role yet it lacks the expertise. Resources allocated to the Office of the Commissioner of Insurance can save potential tremendous costs to The Gambia down the road. This is all the more pressing given the financial condition and practices of a number of the insurance companies.

A more rigorous evaluation of applicants seeking to own and operate insurance companies may have prevented several current owners of problem insurance companies from ever engaging in this profession. Given the element of public trust in the fiduciary aspects of these NBFIs, a rigorous evaluation and ongoing monitoring process is essential.

Recommendations:

- An independent Office of the Commissioner of Insurance needs to be re-established and staffed with qualified professionals.

- The Office of the Commissioner of Insurance should be organized along two functional areas: the evaluation of applicants as fit and proper persons to own and operate an insurance company and the ongoing monitoring and regulation of insurance companies.

Securities Market Authority:

As there is no securities market presently in The Gambia, there has been no need to set up a governing body. However, as the recommendations of this report indicate, there is a need for a securities market and the initial step should be developing a money market.

Recommendation:

If one is to develop the money and capital markets, then it is essential to establish a regulatory authority which will set guidelines to monitor the NBFIs and the commercial banks which engage in securities activities.

The Securities Market Authority should:
- develop an evaluation process for NBFI licenses
- implement risk adjusted / weighted capital requirements
- focus on quality of assets
- establish OTC regulations
- issue investment guidelines for institutional investors.

2.9 Accounting and auditing

Timely and reliable accounting information, both qualitative and quantitative, is essential to a conducive enabling environment for investment. The Gambia has a shortage of suitably qualified accountants which is reflected in the minimal number of companies which have audited financial statements as well as the relatively few audits in which the taxation department engages.

Recommendation:

- Many more accounting professionals are needed in The Gambia.

  International accounting firms should be encouraged to develop a presence in The Gambia. Currently, only KPMG and Panel Kerr and Foster have a local presence. Gambians also should be encouraged to study and become Chartered Accountants.

If The Gambia develops additional service sector opportunities such as a ship registration center and as a tax advantageous domicile for corporations, these will create incremental demand for the services of accounting professionals.

2.10 Disclosure of material information

The disclosure of regular, adequate and reliable information on companies is essential:

- for an efficient equity market
- to enable investors to make informed decisions
- to protect minority shareholders.

The current lack of disclosure of material information is a serious impediment for potential outside investors and lenders. For example, the Consultant was informed that very few commercial bank customers, less than 5%, disclose to the banks their financial statements. This impedes credit analysis and is a factor in the banks' reluctance to make loans which are not fully secured.

Recommendation:

- Establish regulations mandating the disclosure of material information on a regular basis.

  The next step and by far the more difficult, is to ensure that this information is in fact disclosed and in a manner which can be digested and analyzed.

  An accounting and legal profession with greater resources can help in this objective.

  In the medium term, a regional securities rating agency should be established.

2.11 Infrastructure environment

There is a need to develop and to clearly articulate an industrial development program for The Gambia.

The lack of suitable infrastructure is a major impediment to investment. In discussing the infrastructure environment, we are primarily concerned with telecommunications, electricity, water and sewerage, transportation and the availability of factory shells.

Telecommunications:

The telecommunication system in The Gambia is relatively efficient and is a significant plus for investors.

Electricity:

The electricity supply is in need of improvement. Due to unreliable supplies it is preferable to have a standby generator.

Water and Sewerage:

Water and sewerage services are in need of significant improvement.

Transportation:

- Roads are reasonable in the metropolitan Banjul area but still in need of improvement, especially outside this sector.

- Air cargo freight is unreliable and very costly. This is a significant impediment for certain exports especially in the high value seafood, agriculture and floriculture market segments.

- The port is relatively efficient and safe from pilferage. This is a comparative advantage for The Gambia.

- The river transportation system should be overhauled. It has the potential to be an excellent, cost effective source of transportation both internally as well as to service the region.

- Sea freight is expensive both to and from Europe as well as to other African ports. The cost of sea freight is another impediment for investors.

  There are few direct shipping lines between The Gambia and America. This too is an impediment in developing trade ties between the two countries.

- There are no direct air passenger or cargo flights between America and The Gambia. Yet this is essential for developing tourism and trade with America. By air the flight time is only about 6 hours.

2.12 <u>Country models</u>

A number of developing countries have successfully increased and broadened their investment base, especially in exporting a variety of secondary products. An integral element to the success of this strategy has been an infrastructure environment which has been conducive to investors.

Recommendation:

It will be useful to study the experience in infrastructure development of the following countries:

- Mauritius
- Djibouti
- Dubai
- Ghana
- Sri Lanka
- Singapore
- Swaziland
- Hong Kong

The results of the study will be useful not only in identifying effective ways of accomplishing the strategy, but also to highlight pitfalls which otherwise could be very damaging and costly down the road.

Moreover, the study will have application not only with The Gambia, but with a number of other countries which are also at a similar stage in terms of their industrial development program.

3. MICRO FACTORS CRITICAL FOR THE VIABILITY OF VENTURE CAPITAL IN THE GAMBIA

3.1 Financial vehicle to provide Venture Capital

The following structures are possible:

A specialized Venture Capital Management Company and a Venture Fund Company:

This is the model which has been used in a number of African countries and other developing countries. IFC and CDC have a portfolio of Venture Capital investments made with this structure. However, by any measure the performance of these specialized Venture Capital companies has not been a success thus far.

This structure is not recommended for The Gambia for the following reasons:

The Gambia's stage of financial development

Many other developments in the financial sector need to occur before Venture Capital can be successfully implemented in The Gambia. Financial sector development is a step by step evolutionary process and Venture Capital is a latter stage activity.

Attitudes to investment and risk capital

With Venture Capital, you first find out about the problem investments. It is common to declare capital losses before realizing any capital gains. You tend to only know if you have a "winner" over a 3 to 5 year period. You are likely to start to reap the potential capital gains after 5 years and that is in a market where there are established exit mechanisms such as a liquid stock exchange - lacking in The Gambia. That is, the bad news will come before any good news. Naturally, the quality of staff and the degree of hands on involvement with the portfolio investment will be significant factors in the "hit - miss" ratio.

This 5 year time frame is a long term horizon in any market. In a country like The Gambia, where the short term traders' mentality typifies business practice, investors and the activities of financial institutions, it will seem like an eternity.

Local investors' prior experience with risk capital has been mostly disappointing. Given the lack of public education as to the nature of risk capital, together with prior experiences, it is felt that local investors will not tolerate a time frame of this magnitude, especially when there probably will be bad news before any good news. This is all the more so when attractive returns can be made investing in Treasury Bills and re export trading with little risk and a short term investment horizon.

Cash flow considerations

Under the best case scenario, a specialized Venture Capital Company will be cash flow negative for the first 5 years. Few private sector businesses, with profit as a key criteria, can afford to take that outlook. This is all the more so in an environment such as in The Gambia.

The effect of this is that in other African countries where this structure has been applied, USAID has provided grants and loans to subsidize the pre-operating expenses and the operating losses for up to the first 5 years.

This sends a message of the institution being in the aid business as opposed to being market driven and market judged. It sets a poor and unnecessary precedent. There are alternative ways of developing Venture Capital which do not necessitate the American Government allocating millions of dollars to cover these projected losses. If one ends up calculating the cost incurred, via this structure, to generate each job in the invested businesses, it will be seen to be prohibitively expensive. This assessment is made assuming that the invested businesses turn out to be successes, let alone failures.

Tendency for the Venture Capital company to be donor capitalized

When structured in this manner and when one sets up an institution of this kind in an environment lacking a capital market, donors tend to be the ones who capitalize the Venture Capital Fund. Yet all these countries have domestic sources of capital. The key issue is mobilizing this capital. This cannot be done without the enabling, institutional and attitudinal environments being in place.

With this structure, funds tend to be placed in a blind pool. If you are a potential local investor, why would you place your surplus liquid assets with a business which will show losses for at least the first 5 years and when you are supposed to place your funds upfront in a blind pool which you have no control of and do not know how or in what your money is going to be invested? That is, not only are you placing your funds in a blind pool, but you will also have to place blind trust in a new specialized financial institution which tends to be managed by a few expatriates.

Moreover, you are used to investing in physical assets that you directly and discreetly control without any tax liabilities and where you can realize a significant return over the short term.

Where is the incentive for the local investor to place funds with a Venture Capital company? With this structure, it is not surprising that foreign donor investors are the main shareholders. However, there are alternatives which should be able to mobilize domestic sources of capital.

A significant participation of local investors is vital for the success of Venture Capital as it will impose a level of market discipline on both the financial entity and the investees as the activity will be market driven, not donor driven. Venture Capital should be profit driven and not an activity dependent on subsidies and grants. It is possible to engage in Venture Capital under a different vehicle structure whereby subsidies will not be required.

Donor sourced capital does not impose discipline on investees

When an investee is funded through donor sources, it is common for the investee to regard the funds as an entitlement and not an investment with concomitant responsibilities and obligations. This results in a lack of discipline with many investees. This can be one of the factors in the high loss ratio of these investments under this type of structure.

Naturally, risk capital involves a different type of responsibility compared with a loan. Nevertheless, a number of people expressed to the Consultant the concern that an entity providing Venture Capital should not be perceived as the 1990's version of GCDB entitlements.

Expatriate staffing

Many of these specialized Venture Capital companies have been established in countries at a time when the financial sectors have been underdeveloped. Consequently, the supporting environment has been lacking, including the availability of locally trained staff. Expatriate management tends to run these specialized institutions.

If the expatriate is a staff employee of a donor, then that person probably lacks the necessary skills and mentality of a tried and tested experienced venture capitalist. The expatriate management tend to have more experience in the public sector than in running private sector companies in this type of environment.

Additionally, the quality of staff and the degree of hands on involvement in the portfolio companies are critical to the success or failure of the investments. Yet many of these specialized institutions are thinly staffed at the middle and junior management levels.

Size of the Gambian market

Apart from the above described factors, The Gambia is too small a market to sustain at a profit a specialized Venture Capital entity. Moreover, if the vehicle is purely specialized in this manner then it reaps no synergistic or cash flow benefits derived from engaging in a variety of financial products and services.

Venture Capital provided within an existing Commercial Bank:

As a general comment, commercial banks are poorly suited to engage in Venture Capital. The mentality and requisite skills for Venture Capital are totally different from those of commercial banking.

In The Gambia, the commercial banks are very conservative, risk averse and hands off. Yet Venture Capital in its essence, is risk capital, value adding skills and services in a totally hands on manner.

As the commercial banks in The Gambia have a captive market, they are not geared adding value for their customers. Their loans tend to be fully secured and there is little incentive for them to engage in venture capital when they are earning such extraordinary returns at minimal risk with minimal value added.

Nevertheless, the Consultant explored with the existing commercial banks their level of interest in engaging in Venture Capital:

Standard Chartered Bank of The Gambia

Senior management expressed no interest in engaging in Venture Capital. Apart from the lack of any need to engage in this activity, the view was expressed that there would not be the deal flow to warrant Venture Capital activity.

BICI

The General Manager indicated that there was no interest for BICI to engage in Venture Capital.

Continent Bank

This bank has been mired in controversy as to whether its owners are fit and proper persons to have a banking licence. Their original partner, Argent International, withdrew from the joint venture due to concerns on this matter. The issue is still in the courts.

The focus for Continent Bank is getting established and keeping their banking licence. They do not have the capability to engage in Venture Capital.

Meridien Bank Gambia, Ltd.

Meridien was the only bank to express any interest in possibly engaging in Venture Capital. This interest was expressed by their New York Representative Office (which is responsible for the investment banking activities of the Meridien Bank Group) and not from management at Meridien Bank Gambia, Ltd.

In determining their suitability for developing Venture Capital in The Gambia, the following should to be taken into consideration:

Meridien acquired in 1992 portions of the former GCDB. Senior Management stated that their immediate goal is to focus on consolidating the acquisition. This is likely to be their main objective for the next year. Therefore, local management is unlikely to have the resources to focus on Venture Capital in the immediate future: it understandably is not a priority.

Meridien at the Group Level is also focused on a consolidation of an acquisition: the branch network of BIAO which was acquired in 1991. The absorption of a Francophone banking network into an Anglophone banking group poses all sorts of challenges, apart from the overriding challenge of operating in an African environment.

Hence, management at the Group Level is focused on consolidating a major acquisition rather than Venture Capital in specific African countries such as The Gambia.

Opinion is still divided as to the medium term financial viability of Meridien Bank. People speculate as to whether it will be the next BCCI or will it evolve into a special African based international banking group. The institution does appear to be undercapitalized and its loan loss reserves (based on the 1991 financial statements which were the latest available to the Consultant) are less than 10% of the loan book. Given the political and economic environments in which Meridien operates, together with the acquisition of the troubled BIAO network, this amount seems particularly low and renders the institution vulnerable to the inevitable unexpected negative developments which tend to occur in Africa.

Meridien BIAO is a commercial bank with no experience in Venture Capital. In several African countries it has set up leasing companies, securities companies and management services companies. However, none of its country operations are engaging in Venture Capital. Hence, it lacks the inhouse expertise to develop Venture Capital. Moreover, at the Group Level, management which is responsible for all investment banking activities is very thinly spread given the number of potential products and services as well as the number of countries where Meridien has a presence.

Meridien Bank of The Gambia is focused on the traditional bread and butter activities of banks operating in The Gambia: Treasury Bill purchasing, foreign exchange and overdraft financing. Management is from a traditional commercial banking background.

When the Consultant asked Senior Management at Meridien Bank of The Gambia, what level of commitment would Meridien make to a Venture Capital company, the answer was one full time staff and a part time clerk. A commitment at this level is insufficient to seriously develop Venture Capital. Hence, one has to question the level of interest which local management has for Venture Capital.

The view was expressed that if Meridien had an interest in developing the loan book, providing term finance and new financial products and services - that is, activities in addition to the short term, minimal risk financial products which the current banks provide - then they would have kept all the fully performing loan assets of GCDB. Meridien chose not to acquire many fully performing GCDB loans. These assets are now comingled with the value impaired loan book of GCDB in the separate Asset

Management Recovery Fund - this in itself is likely to damage the quality of these assets.

Moreover, they would have gone into the marketplace and hired the best talent available. Yet there have been only two external hires: one for foreign exchange and the other as the financial controller.

A number of people questioned the quality of staff which Meridien has inherited from GCDB. The comment was made that GCDB had a long and painful "death" over several years. During this period, the majority of the quality staff left the fledgling bank. Meridien has not replaced these people at the management level. Yet, for Venture Capital the quality of staff is critical. Unlike a commercial bank, a Merchant Bank and a Venture Capital company have no franchise, only the quality of their service.

In the very least, Meridien should be encouraged to develop new financial products and services, especially for the securities markets. Competition is vital and for secondary markets to have liquidity a minimal critical mass of financial intermediaries is essential. Meridien is the commercial bank most likely to become a financial intermediary in a local securities market.

Venture Capital provided by a Development Finance Institution

GCDB was The Gambia's experiment with Government owned development finance institutions. The failure of GCDB is typical of many development finance institutions. Most are insolvent and riddled with many of the same problems which characterized GCDB.

As a vehicle for medium to long term development finance, development finance institutions have typically failed.

This structure is not recommended for developing Venture Capital in The Gambia. Governmental or donor involvement in Venture Capital is a recipe for failure.

Venture Capital has to be market driven and private sector led, owned and managed.

Venture Capital provided by a Merchant Bank

The concept is for a new merchant bank that will engage in a diversified range of financial products and services, including Venture Capital which will be provided as one of the products and services within corporate finance. Venture Capital will be a second stage activity for the merchant bank. The initial focus of activity, in order to be cash flow positive as soon as possible, will be money market activities, foreign exchange and fee income from providing financial services.

Key issues in examining a merchant bank's suitability as a vehicle for Venture Capital in The Gambia are as follows:

Competition

There is an urgent need for competition in the financial sector. A new merchant bank, by deepening the financial sector, will help in this area. It will shake things up. The former captive market for the commercial banks may no longer be able to be taken for granted.

Financial intermediation

In order to develop a securities market, there must be active financial intermediaries. A merchant bank will be an active financial intermediary.

Cash flow considerations

As the merchant bank will be engaged in a variety of activities, there is no reason why it cannot be cash flow positive within the first year of operations. There is nothing to prevent a merchant bank from also engaging in Treasury Bill trading and foreign exchange operations. Venture Capital is likely to be a second stage activity as management initially will be focused on establishing the bank, training staff and developing product and service lines which can have an immediate positive impact on cash flow. Management will be internally focused before they can focus on adding value to portfolio companies.

Due to this flexibility, the merchant bank will be self supporting and will not require donor subsidies and grants.

Viability

Unlike a specialized Venture Capital company, a merchant bank will achieve:

- diversification of risk through:
    * having a range of products and services
    * maturity matching thereby mitigating term transformation risks
    * a widespread range of customers (individual and corporate) across a broad spectrum of industries
    * both a domestic and international orientation - thereby providing some degree of insulation from vicissitudes of the local economy.

- synergistic benefits:
    - * economies of scale can be achieved as can cross servicing the needs of clients. This is lost in a specialized vehicle.

The Gambia is too small a market for a specialized Venture Capital company to be viable.

Mobilizing local sources of capital

Typically, in other developing countries, specialized Venture Capital companies have done a poor job at mobilizing local sources of capital. The common refrain is that there simply is not sufficient capital available locally. The Consultant is of a different opinion. It is always a source of surprise the extent of liquidity in the unofficial economies of developing countries.

The kerb markets are generally awash with cash. What is lacking is a mechanism to efficiently mobilize these significant sources of capital.

The easy way out is to rely on external funding sources: particularly donor funds. This is detrimental in the medium to long term as it avoids the discipline of the market and fails in playing a catalytic role in capital market development.

By incorporating the Venture Capital Unit within the corporate finance department of a merchant bank, there will be synergistic benefits in the ability to mobilize local sources of capital - both risk equity, debt and hybrids.

Instead of following the traditional funding route of specialized Venture Capital companies - which is to raise a blind pool of capital and then to look for investment opportunities to place these funds in - the Venture Capital Unit first will identify a specific investment opportunity and then on a deal specific basis, the corporate finance specialists will set up a special purpose limited liability company and seek out targeted potential local investors who are likely to be interested in this specific tangible opportunity. That is, there will be no blind pool of funds. Investors will be investing in a specific deal in which they have a high degree of comfort with the project, the entrepreneur and those professionals in the Venture Finance Unit. There is a direct nexus between the investor and the investee. Due to this structure, there is no reason why the merchant bank cannot mobilize local sources of capital as its prime funding source for Venture Capital deals.

Staff and corporate culture/mentality

A new entity has the ability to start from scratch without inheriting any "baggage" both in terms of the quality of staff and a pre existing corporate culture/mentality.

A new merchant bank will be able to:

- attract the top talent:

  A number of talented Gambians have no interest in working for the existing banks as they regard them as conservative and lacking the initiative to develop new products and services. Many of these people would welcome the opportunity to work for a merchant bank which is committed to developing new products and services, treating its staff well and providing profit participation-an incentive which is lacking in the existing banks.

- develop its own corporate culture "de novo":

  This is a very important factor. One of the reasons why Venture Capital subsidiaries of American commercial banks have not been successful is due to the difficulty in operating a Venture Capital operation within the corporate culture of a commercial bank. The two cultures/mentalities are very different and not compatible.

Recommendation:

The recommended financial vehicle to provide Venture Capital in The Gambia is to establish de novo a merchant bank.

At the same time, any of the existing financial institutions which have an interest in engaging in this activity should be encouraged.

3.2 Availability of quality management to staff a Merchant Bank

The primary asset of a merchant bank is the quality of its staff.

The Consultant met a number of talented individuals who could thrive in a merchant bank environment.

There is a reservoir of well educated and skilled Gambians who for various reasons are presently marginalized or underutilized. This is apart from those Gambians who are overseas due to the lack of opportunities in The Gambia. This untapped, or undertapped, skilled management pool is a brain drain in itself and must be harnessed. New financial institutions, such as merchant banks, which seek to hire purely on the basis of merit and to generously reward excellent performers irrespective of sex, religion, tribe or nationality, will be able to attract quality staff. In the areas of finance where the quality of management staff is vital - such as in many areas of money and capital markets and corporate finance - these new institutions will have a decided competitive advantage over other existing financial institutions which do not operate on this basis.

What is lacking is Gambians with hands on merchant banking experience. This is natural in a country where there are no merchant banks. Nevertheless, there are a number of individuals of high intelligence, with excellent education (at schools such as Harvard and Yale) and solid experience in related fields. These are the sort of individuals who if placed in a supportive environment can acquire the requisite specialized skills over a 12-24 month period. One of the roles of the foreign technical partner and APDF will be to facilitate the process of skill transfers. USAID can assist through arranging and financing specific training and education programs.

To attract, maintain and keep honest, capable staff, the merchant bank will have to pay well, look after staff and have a stock options and/or profit sharing plan so that staff can have a vested interest as shareholders in the financial success of the organization.

Recommendations:

- There is available locally the talent pool to staff a merchant bank. Training and education will be required and it is expected that senior management primarily will come from the foreign technical partner and APDF for approximately the first 3 years. It will be expected that within 5 years the merchant bank will be managed at all levels by suitably qualified Gambians.

- Involvement in the training and education of Gambian management will be a catalyst for the process of management indiginization.

- See Appendix 2 for a list of potential management staff for a merchant bank at senior, middle and junior levels.

3.3 Entrepreneurs

The quality of the investees is another critical ingredient to the success or failure of Venture Capital. In essence, what you are investing in is people.

The Consultant met with a number of talented entrepreneurs.

What is lacking for many Gambian entrepreneurs is risk capital and the sort of hands on value added services that a Venture Capital Unit will provide.

Many entrepreneurs in The Gambia have the technical skills but are deficient in terms of finance, marketing and management skills. The Venture Capital Unit will add value in these areas.

The Venture Capital Unit needs to identify quality entrepreneurs matched with projects and businesses where they have a clear competitive advantage: that is, the right entrepreneur for the right project/business. Many businessmen in The Gambia looking for investors tend to be promoters rather than entrepreneurs. They will have excellent public relations skills and will be able to assign the lease of land to a project, but otherwise they may not contribute much to the project. These types tend to have a short term focus which is unsuited to building a business or setting up and running a project. The Venture Capital Unit will have to be careful to separate out the promoters from the entrepreneurs.

Recommendations:

- It is the Consultant's opinion that there is available the talent pool of entrepreneurs to sustain a Venture Capital Unit.

3.4 Deal flow

If there is not a sufficient deal flow volume, then a Venture Capital Unit cannot be sustained. However, the amount of deal flow which is necessary to justify a Venture Capital Unit operating within a merchant bank, is much less than that needed for a self standing specialized Venture Capital company. If the deal flow is slow for a Venture Capital Unit, then the resources can be reallocated to other areas within the corporate finance department. With a specialized Venture Capital company one does not have this flexibility.

Recommendations:

- It would be expected that the Venture Capital Unit will make approximately 2 investments in its first year of operation and then over a 3-5 year period build up to 5 investments a year.

- The average time for holding and adding value to the investments is likely to be in the 5-7 year range. However, at this stage it is very difficult to forecast with any degree of precision.

The length of holding time is dependent on factors such as the type of investment (for example, a start up, an existing mature company, a turnaround etc) and the availability of exit mechanisms to liquidate the investment.

- The equity position taken by the Venture Capital Unit is likely to be between 20-51% of the total equity. The percentage will depend on the type of investment. Furthermore, the financing structure will typically include debt components and hybrid instruments such as convertibles and revenue participation bonds.

- One of the pleasant surprises of the Consultant's trip to The Gambia was the number of potentially viable projects. The initial impression is that there indeed will be a sufficient deal flow to sustain a Venture Capital Unit operating within a merchant bank.

3.5 Local sources of funding to capitalize a merchant bank and to fund its ongoing activities

Local equity investors:

Another vital element to the viability of Venture Capital in The Gambia is the ability to mobilize local equity investors as the single largest shareholding group.

Local equity investors are needed to participate in capitalizing the merchant bank as well as to participate in specific Venture Capital deals.

Apart from Gambian individuals, insurance companies and other institutional investors such as Social Security and Housing Finance Corp., should be significant local equity investors.

The merchant bank could invest some of its own capital, "house money", in specific Venture Capital deals. Knowing that the merchant bank is at risk and is "putting its money where its mouth is" will be a significant marketing tool for mobilizing local individual and institutional investors.

One of the main impediments to mobilizing local sources of capital is the prevailing short term investment horizon. The Government has to lead in creating the conducive enabling environment which will facilitate a change of outlook for those with capital from:

- the current focus on short term exogenous dependent opportunities to more fundamentally sound medium to long term investment opportunities.

- the preference for physically controlling tangible real assets as opposed to investing in a share or bond certificate-paper financial assets.

- the cultural tendency to purchase and hold assets rather than to buy and sell.

Recommendations:

- It will be possible to mobilize local sources of capital. However, the process involves attitudinal changes.

- Key factors in facilitating these attitudinal changes are to:

  * establish investor credibility in the financial institution: a respected,professionally run merchant bank staffed by quality individuals is vital for credibility.

  * structure the Venture Capital Unit in terms of raising funds on a deal by deal basis rather than seeking investors in a blind discretionary pool of funds. Investors want to see where their money has gone and that it has been invested in a tangible real asset and an entrepreneur with which they can identify and be comfortable.

  * rebuild investor confidence in risk capital. Local investors have had a number of bad experiences at informal Venture Capital. There have been a number of instances where local shareholders have been burned and lost their investments due to the investee companies failing for non commercial reasons - let alone failing on purely commercial reasons.

  * develop an education campaign for potential investors as to the potential risks and rewards of investing in securities. One of the benefits of the education campaign should be to foster a greater willingness to hold paper assets rather than physical assets Moreover, the structure for investing on a deal specific basis should also help in this regard.

  * make available the disclosure of material financial information so as to empower potential investors to make informed decisions.

  * improve accounting procedures and auditing standards in order to protect the rights of outside investors.

* create regulatory authorities with qualified, skilled staff to monitor the conduct of financial institutions.

* provide tax incentives for investors in Venture Capital deals so that they are not in any disadvantaged (both in theoretical and practical terms) tax position compared with investing directly in, for example, real estate.

* generate liquidity through the development of a securities market. Such a market will help local investors to sell their shares if they so desire. The lack of liquid exit mechanisms is a factor in the tendency not to sell and instead to buy and hold on to the asset.

- A way in which to reach out to certain closed but powerful Gambian business communities (for example, the Sarahelians, the Lebanese) is to hire talented younger generation members of these communities to work in certain areas of the merchant bank.

Other local funding sources:

The following funding sources can leverage the capital base of the merchant bank and at times also can form part of the total funding package (equity and debt) for specific Venture Capital deals:

- Commercial bank debt financing in the form of credit lines

- Credit from insurance companies

- The merchant bank's own Promissory Notes and/or Commercial Paper issued in the money and bond markets.

- Borrowing in the interbank market.

Additional funding sources for particular product lines include:

- To fund a leasing business, the merchant bank can issue asset backed securities.

- To fund a factoring business, the merchant bank can establish a short term oriented mutual fund as in this case there will be maturity matching. The mutual fund will lower the financing costs of the merchant bank while at the same time improve the interest returns for depositors. This too will disintermediate the commercial banks.

Recommendation:

It should be possible to mobilize other local sources of funding, in addition to equity investors.

3.6 Converted Paris and London Club Debts as sources of discounted investment capital

It may be possible to access discounted Gambian Paris and London Club debts to capitalize a merchant bank and to invest in specific Venture Capital deals.

Recommendation:

It will be useful to explore with the debt holders their interest level in selling these credits at a discount to a third party investor.

At the same time the opinion of the Gambian Government on this matter should be solicited. The rationale will be on the basis that this merchant bank will be a pioneer financial institution committed to developing new financial products and services. In so doing, it will play a major catalytic role in developing the money and capital markets, in facilitating a conducive enabling environment for private investment as well as engaging in Venture Capital.

3.7 Offshore sources of fresh capital

There are a number of bilateral and multilateral agencies which have lending programs geared to the promotion of private sector investment, including Venture Capital. Many of these programs provide funds at below market interest rates.

These programs are an interesting potential funding source and include the following:

- Islamic funds such as the Islamic Development Bank and BADEA
- European Investment Bank (EIB) soft loans for Venture Finance
- African Development Bank (ADB) export stimulation loans (ESL)
- Copaco: Caisse Centrale soft loans for Venture Finance
- Commonwealth Development Corporation soft loans for Venture Finance
- OPEC Fund for International Development

3.8 Exit mechanisms

There are a number of potential exit mechanisms for the Venture Capital investors to realize their paper gains or losses. These include:

- sale to management
- private placement
- merger or acquisition
- public listing.

Recommendation:

Bearing in mind the Gambian market and the absence of a stock exchange, the most feasible potential exit mechanisms are sale to management and private placements.

4. ESTABLISHING A MERCHANT BANK

4.1 Products and services

Methodology:

The following methodology can be applied in strategically planning the product lines and services of the merchant bank:

- Is the activity legally possible?
- if not, then what legislative, regulatory changes need to be made?
- what changes to the enabling environment need to be made ?
- size of the potential market ?
- competition and forecasted market share ?
- capital required ?
- how to forecast revenues and the amount ?
- availability of skilled staff ?
- risks ?
- risk/return and sensitivity analysis.

Each financial product and service will be run as an independent profit center. Support service facilities, such as accounting, administration and personnel will be separately managed cost centers. They will be judged based on their ability to lower unit costs: that is, efficiency level.

Range of products and services:

The following represent a range of products and services which are likely to be feasible, given a conducive enabling environment, for a merchant bank in The Gambia:

Naturally, one merchant bank will not engage in all these activities. Furthermore, the activities which it does engage in will be entered in stages. However, the range does provide an indication of the potential market for financial products and services in The Gambia.

Money Market dealer, trader and discount house

Government paper:

- Treasury Bills
- Central Bank Bills
- Groundnut Bills
- Public Sector Parastatal Bills
- Repos:

These essentially are interbank transactions guaranteed by Government paper such as Treasury Bills. They are ideal for Sharia (Islamic) financial services as discounted securities avoid an explicit interest rate.

Financial paper:

- Certificates of Deposit:

  These instruments are a natural outgrowth of commercial bank time deposits which are packaged and issued by the banks to fund loans.

  They increase liquidity as they are another tradable instrument.

- Bankers Acceptances of trade financing:

  These instruments also are ideal for Sharia (Islamic) financial services as discounted securities avoid an explicit interest rate.

Corporate paper:

- Bills of exchange
- Trade acceptances
- Commercial paper:

  These instruments are short term borrowings by quality companies directly from the money market, thereby disintermediating the commercial banks.

  They are ideal for Sharia (Islamic) financial services as discounted securities avoid an explicit interest rate.

  Experience in other countries has shown that eventually commercial banks seek to join this market as guarantors of the paper (such as by issuing Standby Letters of Credit), or as underwriters or dealers.

Accepting deposits of short term and overnight surplus funds:

Providing loans on an overnight basis or short term:

Foreign exchange dealer and trader

Dalasi and hard currencies:

Other African currencies:

- There is a surprising volume and variety of currencies traded in the informal kerb market. This largely is due to The Gambia being a mercantile, entrepot center for trading with no restrictions on foreign exchange. Currencies ranging from Libyan Dinars to Angolan Kwanzas are readily available. The Mauritanian, Sarahelian and Lebanese traders are the main sources of these currencies.

Dollar domiciliary accounts:

Wholesale and retail foreign exchange operation:

- There is the demand to warrant both a wholesale presence and a retail presence (bureaus de change) to soak up the informal kerb market.

Capital market underwriter, dealer, trader and investor

Government paper:

- Treasury Notes
- Central Bank Notes

Public sector Notes:

- Ports Authority
- Civil Aviation Authority

Corporate Bonds

Mortgage backed bonds:

- Could be tax free
- Could be used to finance housing developers

Quasi equity instruments:

- Participation certificates
- Revenue notes

Corporate finance

Management consulting:

- Operational
- Financial
- Governmental - one example:

  Advise the government on public policy applications of a debt conversion program for outstanding Paris and London Club debts.

- Privatization:

  Advise the Government on the sale of its shareholdings in parastatals:

  * method of sale
  * pricing of the securities
  * analyzing the proposed business plans and feasibility studies of the bidders
  * assessing the bids quantitatively, ranked by amount, with any terms of payment factored in as well as the capacity of bidders to pay
  * assessing the bids qualitatively in terms of which bidder is most likely to successfully operate the business, utilize the assets and to add value.

- Commercialization:

  This is typically a transition step before privatization. Already in The Gambia a number of parastatals have been commercialized - for example the Ports Authority.

Structuring finance:

- Credit market:

  Sourcing for customers the debt component of a financing package.

- Capital market:

  Through private placement or underwriting public offerings of equities and/or bonds.

Venture Capital Unit:

- The suggestion is for an APDF professional to initially head the unit for a 2 year period under contract. This person will be responsible for training 5 sector specialist analysts: agro industry, fisheries, light manufacturing, construction and tourism.

  APDF professionals have expertise in project appraisals and in developing business and investment plans. However, what the organization does not do is to leverage the skills of its professional staff, nor does it effectively mobilize domestic sources of capital for investment in the targeted projects / businesses. The primary investors in APDF projects are donor agencies and other bilaterals and multilaterals.

  With this proposed structure, the skills of one APDF professional will be leveraged fivefold. Within 2 years the 5 Gambian sector specialist analysts should be producing quality project appraisals.

  Moreover, as the Venture Capital Unit will be part of the corporate finance department, there is every reason to expect that significant amounts of local capital will be mobilized for specific Venture Capital deals.

Factoring receivables:

- Including the discounting of post dated checks

Equipment leasing:

- Leasing is a particularly attractive source of financing in Islamic countries as the payments are considered as rent rather than interest on a loan.

Fund management

- Individuals via mutual funds/unit trusts, including mobilizing funds from the rural areas through designated agents or mobile deposit taking.

  These pooling of funds mechanisms can enable individual investors to participate in Treasury Bill yields, shares in privatized parastatals and other securities instruments.

  Mutual funds/Unit trusts will be very price and service competitive in attracting deposits as the effect will be to disintermediate the commercial banks.

- Institutional and corporate investors on a discretionary basis.

- There is a lot of potential in developing Sharia (Islamic) financial products based on profit sharing "musharakah" agreements. Open ended mutual fund certificates will be issued instead of fixed interest on deposits.

- Real Estate Investment Trusts (REITs) which issue shares in the form of "certificates of beneficial interest" are also an attractive financial structure for Islamic investors.

Consumer services

- Credit card representation - for example, Visa, Mastercard, Diners Club franchise.

  This would cater to the growing middle class with an initial target market of 10,000.

- Organizing and managing lotteries on behalf of the Government to raise revenue for specific development projects - for example, schools and hospitals.

Consumer finance

Finance products:

- Instalment sales
- Loans

Types of products financed:

- White goods such as refrigerators, TVs, air conditioners, stoves, home generators
- Air tickets

Payment arrangements in order to minimize bad debts:

- Where possible, arrange for monthly payments to be automatically deducted from payroll. This is feasible for Government employees as well as employees of large corporations.

4.2 Capital & shareholding structure

Amount required:

Given the size of the Gambian market and the type of activities which a merchant bank is likely to engage in, the capitalization should be in the range of:

$1-2 MM (9-18 MM Dalasis).

As the Venture Capital activities of the merchant bank are likely to be a second stage activity, the amount of paid in capital required at the initial stage will probably not exceed 10 MM Dalasis.

Ownership structure

Given the relatively small amount of capital required to establish a merchant bank for the Gambian market, one ideally will have only several major shareholders.

A potential ownership structure is as follows:

- A multilateral, regional or bilateral investor:15-25%(for example, IFC or ADB or CDC or DEG or Caisse Centrale or FMO or Swedcorp)

- A foreign technical partner: 35% (for example, a Nigerian or Ghanaian or South African Merchant Bank and possibly a specialized international Venture Capital company)

- Local Gambian investors:40-50%

The multilateral, regional or bilateral investor will have a put option to sell their shares over a 3-5 year time horizon at a certain strike price with management having the first option to acquire the shares. Local investors will have the second option.

Management, based on performance, will receive stock options and/or profit sharing arrangements.

The anticipated shareholding structure after 3-5 years of operation will be:

° Management	25%
° Foreign technical partner	35%
° Local Gambian investors	40%

4.3 Staff

Apart from the specialist staff, support staff in the following areas will be needed:

- ° Personnel
- ° Financial controller, including accounting
- ° Treasury
- ° Legal
- ° Management Information Systems (MIS)
- ° Administration
- ° Regulatory and legislative compliance as well as internal auditing
- ° Marketing

4.4 Venture Capital legal structure

The legal structure for each Venture Capital deal:

Possibilities include a limited partnership or a special purpose limited liability company.

Recommendation:

The special purpose limited liability company is the recommended structure for The Gambia due to tax and other benefits.

4.5 Estimated time frame and critical path for establishing a merchant bank in The Gambia

MONTHS	GOAL
1 - 4	feasibility study
5 - 6	negotiations with Government and NIB
5 - 6	identification of key staff
7 - 10	identification and negotiations with foreign technical partner
7 - 10	identification and negotiations with multilateral, regional or bilateral shareholder

7 - 10	identification and negotiations with local shareholders
11- 14	formal commitment from shareholders: signing of the shareholders' agreement
11 - 22	obtaining Government approvals and bank or NBFI licence as well as any needed tax, legislative, regulatory and other enabling environment changes
15	hiring of staff
15 - 16	incorporation
15 - 17	capitalization
16 - 18	establishing operational procedures
16 - 21	local training of certain staff
16 - 27	international training of certain staff
17 - 20	renting and preparing offices
20	start operations in stage one activities
30	start operations in stage two activities such as Venture Capital.

Factoring in delays, a reasonable estimate is between 2-3 years from planning stages to being up and running. Bear in mind the fact that numerous enabling environment changes need to take place. This also takes time. When one is a pioneer, the time from planning to start up is always longer than establishing a financial institution in an established market with a conducive enabling environment already in place.

5. ADDITIONAL SERVICE SECTOR OPPORTUNITIES

5.1 Ship registration center

The Gambia could take over Liberia's role in this area due to the ongoing instability in Liberia.

The Gambia has:

- an efficient port
- a stable environment
- the potential for a developing financial sector which should attract essential support professionals such as accountants.

Recommendation:

It is worth exploring this opportunity as it can generate significant revenues for The Gambia as well as employment both for labor at the ports and for the service sector professionals such as accountants and lawyers.

5.2 <u>Tax advantageous domicile for corporations</u>

The Gambia could be marketed as a tax advantageous domicile for foreign company incorporation. This activity can generate significant revenues for the Gambian Government as well as employment opportunities for support service professionals.

Recommendations:

- Decide on this as a matter of Government policy.

- Make the necessary tax, legislative and other enabling environment changes to provide these incentives and to remove any impediments.

- Attract the necessary support service professionals to act as company secretaries, directors, accountants and auditors.

- Model after Bermuda, the British Virgin Islands and the Cook Islands.

6. IMPLEMENTATION AND ACTION PLAN

6.1 Washington DC:

- Meetings to discuss recommendations (especially on Venture Capital, establishing a merchant bank, setting up an OTC, money and capital markets development, solving the transportation bottlenecks) with:

  Harvey and Co.
  USAID
  IFC Capital Markets Department regarding:

  * technical assistance in developing the money market, the capital market and in setting up an OTC market
  * interest in being a 15-25% shareholder in a Gambian merchant bank

* arranging for targeted Gambians to receive specific skills training in other African financial institutions where IFC has a relationship (for example, IFC is a shareholder in the institution).

IBRD regarding funding:

* the construction of an industrial park, export enterprise zone, business incubator park
* other infrastructure improvements such as electricity supply, water and sewerage, roads
* training and education related recommendations.

APDF:

* discuss the potential for placing an APDF professional on a 2 year assignment within the Gambian merchant bank initially to manage the Venture Capital Unit and to be responsible for managing and training 5 Gambian project sector analysts.

FIAS:

* advisory work with the Gambian Government on the enabling environment.

MIGA:

* The Gambia should become a member.

IMF:

* if the merchant bank is capitalized via discounted Paris or London Club debt, will IMF approval be necessary?
* if specific Venture Capital deals are partly funded via discounted Paris or London Club debt, will IMF approval be necessary?
* if IMF has concerns about the monetization effect of conversions, this effect can be sterilized by issuing bonds which will be discounted by the investor in a Gambian secondary market for such instruments. A byproduct of these bonds is that these activities will facilitate the development of a bond primary and secondary trading market in The Gambia.

UNDP:

* especially their assistance in the areas of training and education

- Meetings to discuss their experiences with Venture Capital, merchant banks and lessons to be learnt - especially have they invested in a merchant bank in which Venture Capital is one of the activities:

  IFC
  USAID

- Meetings with various individuals who have particular knowledge of The Gambia, especially the private sector:

- Seminar, round table meeting arranged by Harvey and Co to discuss private sector development for The Gambia and a coordinated response with emphasis on the enabling environment:

  USAID
  IFC
  IBRD
  IMF
  ADB
  APDF
  FIAS
  MIGA
  UNDP
  Bilaterals
  Consultants with relevant experience in The Gambia
  International Venture Capitalists in the private sector
  Gambian embassy
  Certain Gambian students in the US
  Certain Gambian nationals working in the US
  Individuals with special knowledge of the Gambian private sector

- Establish contacts with the Gambian expatriate community and keep them informed of private sector opportunities as they are a source of skilled management employees as well as potential entrepreneurs:

  USAID with the Gambian Embassy

- Meetings to discuss the feasibility of acquiring certain of their outstanding Paris Club Credits in The Gambia:

  Eximbank
  OPIC
  USAID - PL 480 credits

- Meetings to elicit expertise in setting up a Gambian Export Credit and Insurance program:

  Eximbank
  OPIC

- Meetings to address the problem of air and sea transportation services (cargo and passenger) between the USA and The Gambia:

  US Department of Transportation

6.2 USA:

- Visit leading international Venture Capital companies to discuss:

  * methodology and critical path for developing Venture Capital in an African environment
  * critical ingredients for a successful Venture Capital Unit
  * their interest in being a technical partner in a Gambian merchant bank which will engage in Venture Capital.

- Discuss with Equator Bank their interest in being a shareholder in a The Gambian merchant bank as well as their capability for doing so.

- Hire an international marketing, public relations firm to develop a marketing plan for The Gambia to establish its identity and image internationally.

6.3 London:

- Meetings to discuss their experience with Venture Capital, merchant banks and lessons to be learnt - especially have they invested in a merchant bank in which Venture Capital is one of the activities:

  CDC

- Meeting with London Club Creditors to discuss their interest in selling their outstanding Gambian credits.

- Discussions with the potential foreign technical partner for a Gambian merchant bank.

6.4 Paris:

- Meetings to discuss their experience with Venture Capital, merchant banks and lessons to be learnt - especially have they invested in a merchant bank in which Venture Capital is one of the activities:

  Caisse Centrale
  Proparco

- Meeting with Paris Club Creditors to discuss their interest in selling their outstanding Gambian credits.

- Discussions with the potential foreign technical partner for a Gambian merchant bank.

6.5 The Gambia:

- Meetings to discuss recommendations of the report with:

  USAID
  Government of The Gambia including:

  * Office of the President
  * Ministry of Finance and Economic Affairs
  * Central Bank
  * Ministry of Trade and Industry
  * National Investment Board (NIB)

- Seminar, round table to discuss report and Venture Capital:

  * Government officials
  * NIB
  * Private business sector
  * Private financial, legal and accounting sectors
  * Public sector

- Feasibility study for a merchant bank including:

  * identify Gambians to staff the merchant bank: CVs, interviews, references
  * identify local investors in a merchant bank
  * identify quality Gambian entrepreneurs
  * identify specific deal opportunities for Venture Capital
  * identify local investors in Venture Capital deals
  * analysis of the existing financial market
  * analysis of the available and potential financial products and services
  * size of the market for each product or service

* anticipated market share for each product or service
* revenue projections
* revenue budget
* capital and borrowing needs budget
* financial projections:
  income statement
  balance sheet
  cash flow analysis
  sources and uses of funds
* implementation timetable.

° Discussions with the Gambian Government regarding:

  * approval to capitalize the merchant bank and specific Venture Capital deals with converted London and Paris Club debts.
  * tax concessions
  * banking or NBFI license
  * lower reserve and liquidity requirements than those for the commercial banks
  * other enabling environment changes.

° USAID:

  * tax recommendations incorporate through Amex International
  * NIB recommendations incorporate through Robert Nathan
  * training and education recommendations coordinate with:

    IFC
    IBRD
    ADB
    UNDP
    UNIDO

  * money and capital market recommendations incorporate through FSR
  * other private sector development recommendations incorporate through FAPE
  * Venture Capital specific recommendations incorporate through AVCP.

6.6 Abidjan:

° Discussions with:

  African Development Bank Capital Markets Department and Private Sector Department regarding:

  * technical assistance in developing the money market, the capital market and in setting up an OTC market

* their interest in being a 15-25% shareholder in a Gambian merchant bank
* arranging for targeted Gambians to receive specific skills training in other African financial institutions where ADB has a relationship (for example, ADB is a shareholder in the institution).

APDF to:

* discuss the potential for placing an APDF professional on a 2 year assignment within a Gambian merchant bank to initially manage the Venture Capital Unit and to be responsible for managing and training 5 Gambian sector specialist analysts
* identify deal flow opportunities for Venture Capital in The Gambia
* identify potential investors, local and foreign, in a Gambian merchant bank.

6.7 **Nigeria:**

° Discussions with the potential foreign technical partner for a Gambian merchant bank:

IBTC
KMC
Equity Securities
Credit Alliance
Others

6.8 **South Africa:**

° Discussions with the potential foreign technical partner for a Gambian merchant bank:

Vector Finance
Investec
Others

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